503 COMPLETED 4. J89/1:99/48

FALSE CLAIMS ACT AMENDMENTS

n219

HEARINGS

BEFORE THE

SUBCOMMITTEE ON ADMINISTRATIVE LAW AND
GOVERNMENTAL RELATIONS

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SECOND SESSION

ON

FALSE CLAIMS ACT AMENDMENTS

FEBRUARY 5 AND 6, 1986

Serial No. 48

ORIGINAL

3/coo

FALSE CLAIMS ACT AMENDMENTS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON ADMINISTRATIVE LAW AND GOVERNMENTAL RELATIONS

OF THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SECOND SESSION

ON

FALSE CLAIMS ACT AMENDMENTS

FEBRUARY 5 AND 6, 1986

Serial No. 48

Printed for the use of the Committee on the Judiciary

U.S. GOVERNMENT PRINTING OFFICE
59-415 O
WASHINGTON : 1986

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington DC 20402

I

COMMITTEE ON THE JUDICIARY

PETER W. RODINO, Jr., New Jersey, *Chairman*

JACK BROOKS, Texas
ROBERT W. KASTENMEIER, Wisconsin
DON EDWARDS, California
JOHN CONYERS, Jr., Michigan
JOHN F. SEIBERLING, Ohio
ROMANO L. MAZZOLI, Kentucky
WILLIAM J. HUGHES, New Jersey
MIKE SYNAR, Oklahoma
PATRICIA SCHROEDER, Colorado
DAN GLICKMAN, Kansas
BARNEY FRANK, Massachusetts
GEO. W. CROCKETT, Jr., Michigan
CHARLES E. SCHUMER, New York
BRUCE A. MORRISON, Connecticut
EDWARD F. FEIGHAN, Ohio
LAWRENCE J. SMITH, Florida
HOWARD L. BERMAN, California
RICK BOUCHER, Virginia
HARLEY O. STAGGERS, Jr., West Virginia
JOHN BRYANT, Texas

HAMILTON FISH, Jr., New York
CARLOS J. MOORHEAD, California
HENRY J. HYDE, Illinois
THOMAS N. KINDNESS, Ohio
DAN LUNGREN, California
F. JAMES SENSENBRENNER, Jr., Wisconsin
BILL McCOLLUM, Florida
E. CLAY SHAW, Jr., Florida
GEORGE W. GEKAS, Pennsylvania
MICHAEL DeWINE, Ohio
WILLIAM E. DANNEMEYER, California
HANK BROWN, Colorado
PATRICK L. SWINDALL, Georgia
HOWARD COBLE, North Carolina

M. Elaine Mielke, *General Counsel*
Garner J. Cline, *Staff Director*
Alan F. Coffey, Jr., *Associate Counsel*

Subcommittee on Administrative Law and Governmental Relations

DAN GLICKMAN, Kansas, *Chairman*

BARNEY FRANK, Massachusetts
GEO. W. CROCKETT, Jr., Michigan
HOWARD L. BERMAN, California
RICK BOUCHER, Virginia
HARLEY O. STAGGERS, Jr., West Virginia

THOMAS N. KINDNESS, Ohio
HANK BROWN, Colorado
PATRICK L. SWINDALL, Georgia
HOWARD COBLE, North Carolina

William P. Shattuck, *Counsel*
Janet S. Potts, *Assistant Counsel*
Jen Ihlo, *Assistant Counsel*
Kevin C. Richardson, *Assistant Counsel*

CONTENTS

HEARINGS HELD

Page
February 5, 1986 1
February 6, 1986 323

WITNESSES

Hon. Hamilton Fish, Jr., a representative in Congress from the State of New York, accompanied by Alan Coffey, Associate Counsel, Judiciary Committee 96
  Prepared statement 101
Richard K. Willard, Assistant Attorney General, Civil Division, Department of Justice 115
  Prepared statement 120
Hon. Dennis M. Hertel, a representative in Congress from the State of Michigan 175
  Prepared statement 177
Richard P. Kusserow, Inspector General, Department of Health and Human Services, accompanied by D. McCarty Thornton, Supervisory Trial Attorney, Office of General Counsel, Department of Health and Human Services 180
  Prepared statement 186
Christopher T. Cross, president and chief operating officer, University Research Corp., on behalf of the U.S. Chamber of Commerce; and Frank H. Menaker, Jr., vice president and general counsel, Martin Marietta, on behalf of Aerospace Industries, Association of America, Inc., accompanied by Paul Besozzi, partner, Law Firm of Hennessey, Stambler & Siebert 225
  Statement of Christopher T. Cross 228
  Statement of Frank H. Menaker, Jr 241
Howard W. Cox, Deputy Assistant Inspector General, Department of Defense 273
  Prepared statement 279
Hon. Charles E. Grassley, a U.S. Senator from the State of Iowa 323
  Prepared statement 325
Hon. Andy Ireland, a Representative in Congress from the State of Florida 328
Hon. Berkley Bedell, a Representative in Congress from the State of Iowa 329
  Prepared statement 332
John M. Gravitt, accompanied by James B. Helmer 339
  Prepared statement of Mr. Gravitt 343
  Prepared statement of Mr. Helmer 357
John Phillips, executive director, Center for Law in the Public Interest 392
  Prepared statement 397
Marshall J. Breger, chairman, Administrative Conference of the United States, accompanied by Richard K. Berg, general counsel, and Jeffrey S. Libbers, research director 424
  Prepared statement 427
Karen Hastie Williams, chairman, legislative liaison committee of the public contract law section of the American Bar Association, accompanied by Alan C. Brown, chairman of the section's procurement fraud committee 442
  Prepared statement 447

ADDITIONAL MATERIAL

Letter to Hon. Dan Glickman from John R. Bolton, Assistant Attorney General, Department of Justice, dated April 10, 1986 167

Page
Statement of Congressman Fortney H. (Pete) Stark, and the combined statement of Senators Cohen, Roth, and Levin 291
Letter to Paul D. Lynch from W.G. Krall of General Electric Co., dated November 21, 1983 380
Copies of General Electric Co. vouchers 383
Letter to Hon. Dan Glickman from Richard K. Willard, U.S. Department of Justice, dated February 20, 1986 419
Statement of National Association of Manufacturers 472
Statement of National Conference of Boards of Contract Appeals Members 478
Statement of the Associated General Contractors of America 492
Statement of the American Farm Bureau Federation 496

FALSE CLAIMS ACT AMENDMENTS

WEDNESDAY, FEBRUARY 5, 1986

House of Representatives,
Subcommittee on Administrative Law
and Governmental Relations,
Committee on the Judiciary,
Washington, DC.

The subcommittee met, pursuant to call, at 10:15 a.m., in room 2237, Rayburn House Office Building, Hon. Dan Glickman (chairman of the subcommittee) presiding.

Present: Representatives Glickman, Berman, Staggers, and Kindness.

Staff present: William P. Shattuck, counsel; Jen Ihlo, assistant counsel; Kevin C. Richardson, associate counsel; and Florence McGrady, legal assistant.

Mr. **Glickman**. Good morning.

The purpose of today's hearing is to consider amendments to the False Claims Act. This act is the vehicle by which the Government prosecutes civil fraud. Although fraud against the Government is not a new problem, widespread abuse has become increasingly apparent and has gained much attention by the media. It has also prompted understandable taxpayer concern, especially in the realm of defense contractors.

The False Claims Act was originally enacted in 1863 because of reports that Government contractors were bilking the U.S. Government during the Civil War. In one case in 1861, a Major McKinstry purchased about 1,000 mules for the United States at $119 each, although the mules were, and he knew they were, unfit for service and almost useless because some were totally blind and diseased. That case led to the adoption of the False Claims Act.

We have come a long way from the use of mules in the military, but fraud perpetrated against the U.S. Government is still prevalent—and I might mention with respect to all agencies, civil as well as military, and on a much larger scale.

A 1981 GAO report pointed out that during a 2½-year review there were 77,000 cases of fraud and other illegal activities reported by 21 Federal agencies. GAO estimated the loss to the Government to be between $150 and $220 million. This figure is admittedly a low estimate, but does not include the cost of undetected fraud or cases involving Federal funds where State and local jurisdictions had primary investigatory responsibility.

The False Claims Act has been substantially unchanged since it was enacted in 1863. For example, the $2,000 civil penalty has never been altered. CRS reported that the buying power of $2,000 in 1863 is now about $17,000. I think this points out in dollars and cents the necessity for modernizing this statute.

I think it is important that we look closely at the False Claims Act and see what changes are necessary to make the act an effective tool for combating fraud in 1986, and to insure that it will continue to be effective for the next 20 years or so.

The purpose of the statute is to impose civil liability for presenting false claims against the Government; preparing a written instrument that contained false or fictitious statements with the purpose of aiding in the payment or approval of such a claim; or conspiring to defraud the Government by obtaining payment or allowance of a false claim. The theory behind the statute is to allow the Government to recoup losses which it suffered because of fraud.

Some of the proposed amendments to the false claims statute include: one, clarifying the burden of proof; two, expanding the venue; three, increasing the amount of damages; four, authorizing the use of civil investigative demands; and five, strengthening the qui tam or citizen action provisions.

It is also important, I think, to note that the burden of proof in a criminal case is much higher than that in a civil case. Therefore, the likelihood that stiffer civil penalties will result in a more frequent use of the civil statute than the criminal statute, thereby making the civil statute the more effective remedy for fraud against the U.S. Government.

During the hearings we will not only look at the False Claims Act but explore a proposal to create an administrative remedy under which false claims can be pursued by a Federal agency without the expense of a court trial.

In the 1981 GAO report, the Comptroller General also reported that during a 2½-year GAO review, the Department of Justice took civil action in only 28 of 393 civil fraud cases which were referred to it by Federal agencies. Many times, the dollar amount of loss suffered by the Government as a result of fraud is so low that the cost of pursuing the claim in court far exceeds the amount that could be obtained through a judgment. Still, those losses should be recouped.

I believe that persons who commit fraud against the U.S. Government should not get away with it just because the cost of pursuing a case is too high. Therefore, we will look closely at the possibility of creating administrative remedies which will deal with this type of situation.

By modernizing the False Claims statute and creating an administrative remedy for fraud cases, we can not only insure that those guilty of defrauding the Government will be held accountable, but we can also recoup many losses suffered by the Government and perhaps deter those from happening in the future.

At this time, with a $200 billion deficit, we should be actively trying to recoup losses of tax dollars which result from fraud, wherever it is perpetrated against the Federal Government.

The legislative movement in this area has been spurred by reports of fraudulent activities involving Pentagon contracts—and I might also mention HHS contracts as well—but the fact of the matter is that the legislation we are considering will impact Government contracts across the board. It is vitally important, especially at this time, as we reevaluate the whole range of Government programs, that we take strong steps to assure that people of this country can have confidence in the integrity of those programs through which their hard-earned tax dollars are spent. These hearings are intended to make sure we have the tools to do so.

[Copies of H.R. 2264, H.R. 3317, H.R. 3334. H.R. 3335, and H.R. 3753 follow:]

I

99TH CONGRESS
1ST SESSION

H. R. 2264

To amend title 5, United States Code, to provide civil penalties for false claims and statements made to the United States, to certain recipients of property, services, or money from the United States, or to parties to contracts with the United States, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

APRIL 29, 1985

Mr. HERTEL of Michigan introduced the following bill; which was referred to the Committee on the Judiciary

---

A BILL

To amend title 5, United States Code, to provide civil penalties for false claims and statements made to the United States, to certain recipients of property, services, or money from the United States, or to parties to contracts with the United States, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Program Fraud Civil Penalties Act of 1985".

SEC. 2. (a)(1) The Congress finds that—

(A) fraud in Government programs is a serious and growing problem;

(B) present civil and criminal remedies for program fraud are not sufficiently responsive to this problem;

(C) fraud in Government programs results in the loss of millions of dollars annually; and

(D) freud in Government programs undermines the integrity of these programs by allowing ineligible persons to participate and receive Federal funds to which they are not entitled.

(2) The Congress further finds that it is desirable to create an expeditious and inexpensive administrative procedure which Federal agencies may use to impose an administrative penalty for false, fictitious, or fraudulent claims and statements.

(b) The purposes of this Act are—

(1) to allow Federal agencies which are the victims of false, fictitious, and fraudulent claims and statements to have an administrative remedy penalizing persons who submit such claims and statements;

(2) to provide an administrative penalty procedure which is comparable with administrative penalty procedures with respect to Government contracts, personnel disciplinary proceedings, and Government grants; and

(3) to provide reasonable due process protections to all persons who are subject to the adjudication of

administrative penalties for false, fictitious, or fraudulent claims or statements.

SEC. 3. (a) Title 5 of the United States Code is amended by inserting after chapter 7 the following new chapter:

"CHAPTER 8—ADMINISTRATIVE PENALTIES AND ASSESSMENTS FOR FALSE CLAIMS AND STATEMENTS

"Sec.
"801. Definitions.
"802. False claims and statements; liability.
"803. Hearing and determination by authority head; subpena authority.
"804. Judicial review.
"805. Collection of civil penalties and assessments.
"806. Limitations.
"807. Right to setoff.
"808. Regulations.
"809. Reports.

"§ 801. Definitions

"(a) As used in this chapter—

"(1) 'authority' means any establishment as defined in section 11(2) of the Inspector General Act of 1978 (92 Stat. 1109), any executive department, any military department, and the United States Postal Service;

"(2) 'authority head' means—

"(A) the head of an authority, or

"(B) an official or employee of the authority designated, in regulations promulgated by the head of the authority, to make findings and determinations under this chapter on behalf of the head of the authority;

"(3) 'claim' means any request or demand, whether under a contract or otherwise—

"(A) to an authority for property, services, or money (including money representing grants, loans, insurance, or benefits); or

"(B) to a recipient of property, services, or money from an authority or to a party to a contract with an authority—

"(i) for property or services if the United States provided such property or services or any portion of the funds for the purchase of such property or services or will reimburse such recipient or party for the purchase of such property or services; or

"(ii) for the payment of money (including money representing grants, loans, insurance, or benefits) if the United States provided any portion of the money requested or demanded or will reimburse such recipient for any portion of the money paid on such request or demand;

"(4) 'statement' means any written representation or certification—

"(A) with respect to a claim; or

"(B) with respect to—

"(i) a contract with, or a bid or proposal for a contract with,

"(ii) a grant, loan, or benefit from,

"(iii) an application for insurance from, or

"(iv) an application for employment with,

an authority, or any State, political subdivision of a State, or other party acting on behalf of, or based upon the credit or guarantee of, an authority;

"(5) 'person' means any individual, partnership, corporation, association, or private organization;

"(6) 'investigating official' means—

"(A) the Inspector General in an authority which is authorized an Inspector General by the Inspector General Act of 1978 (92 Stat. 1101) or any other Federal law; or

"(B) in the case of an authority which is not authorized an Inspector General by the Inspector General Act of 1978 (91 Stat. 1101) or any other Federal law, any official or employee of the authority when designated by the head of the authority to conduct investigations under the provisions of section 803(a)(1) of this title; and

"(7) 'reviewing official' means any official or employee of an authority—

"(A) whose rate of basic pay is equal to or greater than the minimum rate of basic pay for grade GS-18 under section 5332 of this title; and

"(B) who is designated by the head of the authority to make the determination provided in section 803(a)(2) of this title.

"(b) For the purposes of subsection (a)(3) of this section—

"(1) each voucher, invoice, claim form, or other individual request or demand for property, services, or money constitutes a separate claim whether submitted separately or together with other claims;

"(2) each request or demand for property, services, or money constitutes a claim regardless of whether such property, services, or money is actually delivered or paid; and

"(3) a claim shall be considered made to an authority, recipient, or party when such claim is made to an agent, fiscal intermediary, or other entity, including any State or political subdivision thereof, acting for or on behalf of such authority, recipient, or party.

"(c) For the purposes of subsection (a)(4) of this section—

"(1) each written representation or certification constitutes a separate statement whether submitted separately or together with other statements; and

"(2) a statement shall be considered made to an authority although such statement is actually made to an agent, fiscal intermediary, or other entity, including any State or political subdivision thereof, acting for or on behalf of such authority.

"§ 802. False claims and statements; liability

"(a) For purposes of this chapter—

"(1) a claim is false when the claim—

"(A) includes or is supported by any false, fictitious, fraudulent, or intentionally misleading statement, document, record, or accounting or bookkeeping entry;

"(B) is for payment for the provision of property or services which the claimant has not provided, or has not provided in accordance with the terms of the contract on which such claim is based, or has provided in violation of any applicable Federal or State statute or regulation; or

"(C) is for the payment of an amount in excess of the amount which is properly due; and

"(2) a statement is false when a material fact—

"(A) is asserted in such statement and is false, fictitious, fraudulent, or intentionally misleading; or

"(B) is omitted from such statement and—

"(i) as a result of the omission, such statement is substantially false, fictitious, or fraudulent or, in the case of an intentional omission, is intentionally misleading; or

"(ii) the person making such statement has a duty to include such material fact in the statement.

"(b) Any person who, on or after the effective date of the Program Fraud Civil Penalties Act of 1983, knowingly makes, presents, or submits, or knowingly causes to be made, presented, or submitted, a false claim or statement, is liable to the United States for—

"(1) a civil penalty of not more than $10,000 for each false claim or statement; and

"(2) an assessment of not more than double—

"(A) the full amount of money paid to and the full value of property or services delivered to a person as a result of the false claim or statement of such person; or

"(B) the amount of damages, including the amount of consequential damages and the cost of investigating such false claim or statement, sustained by the United States as a result of the false claim or statement.

"(c) Except as provided in section 803(b)(5) or 805(f)(1) of this title, the total amount of the penalty and assessment determined under this section shall not be less than the amount of damages sustained by the United States as a result of the false claim or statement.

"(d)(1) The penalties and assessments provided in this section shall be in addition to all criminal penalties provided by law.

"(2) Except as provided in subsection (e) of this section, the authority head may use any administrative and contractual remedy authorized by any other applicable provision of Federal law in addition to the provisions of this chapter to impose or enforce a civil penalty and assessment for false claims and statements.

"(e) Notwithstanding any other provision of Federal law, a civil penalty or assessment imposed under any other provision of Federal law in any case subject to this chapter may be in any amount authorized in this section.

"§ 803. Hearing and determination by authority head; subpena authority

"(a)(1) The investigating official of an authority shall investigate allegations that a person is liable under section 802(b) of this title and report the findings and conclusions to the reviewing official of the authority.

"(2) If the reviewing official determines, based upon the report of the investigating official or upon information from any other source, that there is probable cause to believe that a person is liable under section 802(b) of this title, the reviewing official shall refer the allegations contained in such report to the authority head for a hearing. Before referring the allegations to the authority head, the reviewing official may refer the allegations to the investigating official and require the investigating official to obtain more information with respect to the allegations.

"(b)(1) The authority head shall conduct a hearing on the record regarding any allegation referred to him pursuant to subsection (a) of this section to determine, based on the preponderance of the evidence—

"(A) the liability of any person under section 802(b) of this title;

"(B) the amount of damages suffered by the United States as a result of the false claim or statement creating the liability of such person; and

"(C) the amount of any penalty and assessment to be imposed on such person.

"(2) The person alleged to be liable under section 802(b) of this title shall be entitled—

"(A) to written notice of the hearing specifically setting forth all allegations and the date, time, and place for such hearing;

"(B) to be present at such hearing;

"(C) to be represented by counsel;

"(D) to present evidence; and

"(E) to cross-examine any witnesses.

"(3) Each hearing under paragraph (1) of this subsection shall be conducted in an impartial manner and resolve the issues expeditiously and inexpensively consistent with fundamental fairness. A written decision including findings and determinations shall be issued after the conclusion of the hearing.

"(4)(A) Except as provided in subparagraph (B) of this paragraph and section 804 of this title, the findings and determinations of the authority head issued in connection with a hearing conducted under paragraph (1) of this subsection are final.

"(B) If the authority head conducting the hearing under paragraph (1) of this subsection is an individual described in section 801(a)(2)(B) of this title, the amount of the penalty and assessment imposed on a person may be reduced by the authority head described in section 801(a)(2)(A) of this title to any amount not less than the amount provided in section 802(c) of this title.

"(5) The total amount of the penalty and assessment determined under this section may be less than the amount provided in section 802(c) of this title if the authority head determines that a lower amount is in the best interest of the United States and enters in the written decision and makes available for public inspection the determination and the reasons for the determination.

"(c) After a hearing pursuant to subsection (b) of this section, the authority head shall promptly send to any person determined to be liable under section 802(b) of this title written notice of the findings and determinations of the authority head and the right to judicial review under section 804 of this title.

"(d) For the purposes of an investigation under subsection (a) of this section the investigating official is authorized—

"(1) to administer oaths or affirmations; and

"(2) to require by subpena the attendance and testimony of witnesses and the production of all information, documents, reports, answers, records, accounts, papers, and other data and documentary evidence necessary to conduct such investigation.

"(e) For the purposes of conducting a hearing under subsection (b) of this section, the authority head is authorized—

"(1) to administer oaths or affirmations; and

"(2) to require by subpena the attendance and testimony of witnesses and the production of all information, documents, reports, answers, records, accounts, papers, and other data and documentary evidence which the authority head considers relevant and material to the hearing.

"(f) In the case of contumacy or refusal to obey a subpena issued pursuant to subsection (d) or (e) of this section, the investigating official or authority head, as the case may be, may invoke the aid of any district court of the United States where such investigation or hearing is being conducted, or where such subpenaed person resides or conducts business. The district courts of the United States shall have jurisdiction to issue an appropriate order for the enforcement of any such subpena. Any failure to obey such order of the court is punishable by such court as contempt.

"(g) Unless a petition is filed as provided in section 804 of this title, the determination of liability pursuant to this section shall be final and shall not be subject to judicial review.

"§ 804. Judicial review

"(a) Any person who has been determined pursuant to section 803 of this title to be liable under section 802(b) of this title may obtain review of such determination in the United States Court of Appeals for the circuit in which such person resides or in which the claim or statement upon which the determination of liability is based was made, presented, or submitted, or for the District of Columbia Circuit, by filing in such court, within sixty days after the date on which the notice required by section 803(c) of this title is sent, a written petition that such determination be modified or set aside. The clerk of the court shall transmit a copy of such petition to the authority head concerned and to the Attorney General. Upon receipt of the copy of such petition the authority head shall transmit to the Attorney General the record in the proceeding resulting in the determination of liability. Except as otherwise provided in this section, the courts of appeals of the United States shall have jurisdiction to review the findings and determinations in issue and to affirm, modify, remand for further consideration, or set aside, in whole or in part, the findings and determinations of the authority head, and to enforce such findings and determinations to the extent that such findings and determinations are affirmed or modified.

"(b) The findings of the authority head with respect to questions of fact, if supported by substantial evidence on the record considered as a whole, shall be conclusive.

"(c) The determination of the authority head as to the amount of any penalty and assessment shall be conclusive and shall not be subject to review except to determine whether such amount exceeds the maximum amount provided in section 802 of this title.

"(d) Any court of appeals reviewing, under this section, the findings and determinations of the authority head shall not consider any objection that was not raised in the hearing conducted pursuant to section 803(b) of this title, if any, absent a showing of extraordinary circumstances causing the failure to raise the objection. If any party shows to the satisfaction of the court that additional evidence not presented at such hearing is material and that there were reasonable grounds for the failure to present such evidence at such hearing, the court shall remand the matter to the authority head for consideration of such additional evidence.

"(e) Upon a final determination by the court of appeals that a person is liable under section 802(b) of this title, the court shall enter a final judgment for the appropriate amount in favor of the United States, and such judgment may be recorded and enforced by the Attorney General to the same extent and in the same manner as a judgment entered by any United States district court.

"§ 805. Collection of civil penalties and assessments

"(a) The Attorney General, with the support of the authority head when required, shall be responsible for judicial enforcement of any civil penalty or assessment imposed pursuant to the provisions of this chapter.

"(b) Any penalty or assessment imposed in a determination which has become final pursuant to section 803(g) of this chapter may be recovered in a civil action brought by the Attorney General. In any such action, no matters that were raised or that could have been raised in a hearing conducted under section 803(b) of this title or in a review pursuant to section 804 of this title may be raised as a defense, and the determination of liability and the determination of amounts of penalties and assessments shall not be subject to review.

"(c) The district courts of the United States and of any territory or possession of the United States shall have jurisdiction of any action commenced by the United States under subsection (b) of this section.

"(d) Any action under subsection (b) of this section may, without regard to venue requirements, be joined and consolidated with or asserted as a counterclaim, cross-claim, or setoff by the United States in any other civil action which includes as parties the United States and the person against whom such action may be brought.

"(e)(1) The United States Claims Court shall have jurisdiction of any action under subsection (b) of this section to recover any penalty and assessment if the cause of action is asserted by the United States as a counterclaim in a matter pending in such court. The United States may join as additional parties in such counterclaim all persons who may be jointly and severally liable with the person against whom such counterclaim is asserted.

"(2) No cross-claims or third-party claims not otherwise within the jurisdiction of the United States Claims Court shall be asserted among additional parties joined under paragraph (1) of this subsection.

"(f)(1) Except as provided in paragraph (2) of this subsection, the authority head may compromise or settle any penalty and assessment determined pursuant to section 803 of this title. No compromise or settlement under this subsection shall provide for a recovery of an amount less than the amount described in section 802(c) of this title unless the authority head makes the determination and takes the action provided in section 803(b)(5) of this title.

"(2) The Attorney General shall have exclusive authority to compromise or settle any penalty and assessment the determination of which is the subject of a pending petition pursuant to section 804 of this title or a pending action to recover such penalty or assessment pursuant to this section.

"(g) Whenever a penalty and assessment is imposed and collected pursuant to this chapter and part of any money paid or property or services delivered as a result of the false claim or statement on which such penalty and assessment is based was provided by a State or political subdivision thereof which has not previously been reimbursed for such money or property, the United States shall reimburse such State or political subdivision the lesser of—

"(1) an amount bearing the same ratio to the civil penalty and assessment recovered as the amount paid, or the cost to the State or political subdivision of property or services delivered, by the State or political subdivision on the basis of such false claim or statement bears to the total amount paid, or total cost of property or services delivered, based on such false claim or statement; or

"(2) the total amount actually paid, or the total actual cost to the State or political subdivision of property or services delivered, by the State or political subdivision on the basis of such false claim or statement.

"(h) Except as provided in subsection (g) of this section, any amount of penalty and assessment collected under this chapter shall be deposited as miscellaneous receipts in the Treasury of the United States.

"§ 806. Limitations

"(a)(1) Prior to initiating a proceeding under section 803(b) of this title the authority head shall transmit to the Attorney General written notice of the intention to initiate such proceeding together with the reasons for such intention.

"(2) The authority head may initiate a proceeding under section 803(b) of this title if—

"(A) the Attorney General approves the initiation of such proceeding; or

"(B) the Attorney General takes no action to disapprove the initiation of such proceeding within ninety days after the date on which the notice required by paragraph (1) of this subsection is received or within such longer period after such date as is provided in a memorandum of understanding entered into by the authority head and the Attorney General with respect to such proceeding.

"(b)(1) No proceeding under section 803(b) of this title shall be commenced more than six years after the date on which the claim or statement alleged to be a false claim or statement is made, presented, or submitted.

"(2) A proceeding under such section is commenced by mailing by registered or certified mail the notice required in section 803(b)(2)(A)of this title.

"(c) A civil action to recover a penalty and assessment under section 805 of this title shall be commenced within three years after the date on which the determination of liability for such penalty and assessment becomes final.

"(d) If at any time during the course of proceedings brought pursuant to this chapter the authority head receives or discovers any specific information regarding bribery, gratuities, conflict of interest, or other corruption or similar activity in relation to a false claim or statement, the authority head shall immediately report such information to—

"(1) the Inspector General of the authority, if an Inspector General is authorized for the authority by the Inspector General Act of 1978 (92 Stat. 1101) or any other Federal law, for transmission to the Attorney General; or

"(2) the Attorney General, if the authority is not authorized an Inspector General by the Inspector General Act of 1978 (92 Stat. 1101) or any other Federal law.

"(e) If the Attorney General transmits to an authority head a written finding that the continuation of any proceeding under section 803 of this title may adversely affect any pending or potential criminal or civil action related to an alleged false claim or statement under consideration in such proceeding, such proceeding shall be immediately stayed and may be resumed only upon written authorization of the Attorney General.

"(f) No proceeding shall be commenced under section 803(b) of this title with respect to any claim, statement, or group of claims or statements submitted before the commencement of such proceedings by any person or group of persons acting in concert if (1) the amount of money or the value of property or services requested or demanded in such claim, statement, or group of claims or statements exceeds $100,000, or (2) the amount of damages, including the amount of consequential damages, sustained by the United States as a result of such claim, statement, or group of claims or statements exceeds $100,000.

"§ 807. Right to setoff

"(a)(1) The amount of any penalty and assessment which has become final under section 803(g) of this title, or for which a judgment has been entered under section 804(e) or 805 of this title, or any amount agreed upon in a settlement or compromise under section 805(f) of this title, may be deducted from any sum, including a refund of an overpayment of Federal taxes, then or later owing by the United States to the person liable for such penalty and assessment.

"(2) The authority head shall transmit written notice of each deduction made under this paragraph to the person liable for such penalty and assessment.

"(3) All amounts retained pursuant to this paragraph shall be remitted to the Secretary of the Treasury for deposit in accordance with section 805(h) of this title.

"(b) An authority head may forward a certified copy of any determination as to liability for any penalty and assessment which has become final under section 803(g) of this title, or a certified copy of any judgment which has been entered under section 804(e) or 805 of this title to the Secretary of the Treasury for action in accordance with subsection (a) of this section.

"§ 808. Regulations

"(a) The head of each authority shall issue rules and regulations implementing paragraphs (1), (2), and (3) of section 803(b) of this title and such additional rules and regulations as may be necessary to carry out the provisions of this chapter. Such rules and regulations shall insure that investigating officials are not responsible for making the determinations or conducting the hearing required in section 803(b) of this title or making the collections under section 805 of this title.

"(b) The Attorney General may enter into a memorandum of understanding with the head of any authority to pro-

BEST COPY

vide expeditious procedures for approving or disapproving the initiation of proceedings under section 803(b) of this title and for referral of matters for action under sections 804, 805, and 806(e) of this title. Such memorandum of understanding may provide advanced authorization to initiate proceedings under section 803(b) of this title with respect to any particular type or class of alleged false claims or statements if not otherwise barred by section 806 of this title.

"§ 809. Reports

"(a) Each investigating official shall, not later than October 31 of each year, prepare an annual report summarizing actions taken under this chapter during the most recent twelve-month period ending September 30. Such report shall include—

"(1) a summary of matters referred to the authority head under section 803(a)(2) of this title during such period;

"(2) a summary of matters transmitted to the Attorney General under section 806(a)(1) of this title during such period;

"(3) a summary of all proceedings initiated by the authority head under section 803(b) of this title, and the results of such proceedings, during such period; and

"(4) a summary of the actions taken during such period to collect any civil penalty or assessment imposed under this chapter.

"(b) The annual report of an investigating official shall be furnished to the authority head not later than October 31 of the year such report is prepared. Each such report shall be transmitted to the appropriate committees and subcommittees of Congress in the same manner as the October 31 reports of Inspectors General are transmitted under section 5 (b) of the Inspector General Act of 1978 (92 Stat. 1103).".

(b) The table of chapters at the beginning of part I of title 5, United States Code, is amended by inserting after the item relating to chapter 7 the following new item:

"8. Administrative Penalties and Assessments for False Claims and Statements.. 801.".

SEC. 4. The regulations required by section 808 of title 5, United States Code, as added by section 3(a) of this Act, shall be promulgated not later than one hundred and eighty days after the effective date of this Act.

SEC. 5. This Act and the amendments made by this Act shall take effect December 31, 1985.

○

99TH CONGRESS
1ST SESSION

H. R. 3317

To amend the False Claims Act, and title 18 of the United States Code regarding penalties for false claims, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 17, 1985

Mr. IRELAND introduced the following bill; which was referred to the Committee on the Judiciary

---

A BILL

To amend the False Claims Act, and title 18 of the United States Code regarding penalties for false claims, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 3729 of title 31, United States Code, is amended by—

(1) inserting "(a)" before "A person";

(2) striking out "$2,000" and inserting in lieu thereof "$10,000";

(3) striking out "2 times the amount of damages" and inserting in lieu thereof "3 times the amount of

damages in addition to the amount of the consequential damages"; and

(4) adding at the end thereof the following:

"(c) For purposes of this section, the terms 'knowing' and 'knowingly' mean the defendant—

"(1) had actual knowledge; or

"(2) had constructive knowledge in that the defendant acted in reckless disregard of the truth;

and no proof of intent to defraud or proof of any other element of a claim for fraud at common law is required.".

SEC. 2. Section 3730(b) of title 31, United States Code, is amended—

(1) in paragraph (1), by striking out the fourth sentence and inserting in lieu thereof "The action may be brought in the judicial district where the defendant, or in the case of multiple defendants, where any one defendant is found, resides, or transacts business, or where the violation allegedly occurred.";

(2) in paragraph (2), by striking out "if the Government—" through the end of the paragraph and inserting in lieu thereof "if the Government by the end of the 60-day period does not enter, or gives written notice to the court of intent not to enter the action.";

(3) in paragraph (3), by striking out "action is conducted only by the Government" and inserting in

lieu thereof "person bringing the action shall have a right to continue in the action as a full party on the person's own behalf"; and

(4) by striking out paragraph (4) and inserting in lieu thereof the following:

"(4) If the Government does not proceed with the action within the 60-day period after being notified, the court, without limiting the status and rights of the person initiating the action, may nevertheless permit the Government to intervene at a later date if the Government demonstrates to the court that it came into possession of new material evidence or information not known by the Government within the 60-day period after being notified of such action.

"(5) Unless the Government proceeds with the action within 60 days after being notified, the court shall dismiss the action brought by the person if the court finds that—

"(A) the action is based on specific evidence or specific information the Government disclosed as a basis for allegations made in a prior administrative, civil, or criminal proceeding; or

"(B) the action is based on specific information disclosed during the course of a congressional investigation or based on specific public information disseminated by any news media.

If the Government has not initiated a civil action within six months after becoming aware of such evidence or information, or within such additional time as the court allows upon a showing of good cause, the court shall not dismiss the action brought by the person. The defendant must prove the facts warranting dismissal of such case.".

SEC. 3. Section 3730(c) of title 31, United States Code, is amended to read as follows:

"(c)(1) If the Government proceeds with the action within 60 days after being notified, and the person bringing the action has disclosed relevant evidence or information the Government did not have at the time the action was brought, such person shall receive at least 15 percent but no more than 20 percent of the proceeds of the action or settlement of the claim. Any such payment shall be paid out of such proceeds. If the person bringing the action substantially contributes to the prosecution of the action, such person shall receive at least 20 percent of the proceeds of the action or settlement and shall be paid out of such proceeds. Such person shall also receive an amount for reasonable expenses the court finds to have been necessarily incurred, in addition to reasonable attorneys' fees and costs. All such expenses, fees, and costs shall be awarded against the defendant.

"(2) If the Government does not proceed with the action within 60 days after being notified, the person bringing the action or settling the claim shall receive an amount the court decides is reasonable for collecting the civil penalty and damages. The amount shall not be less than 25 percent and no more than 30 percent of the proceeds of the action or settlement and shall be paid out of such proceeds. Such person shall also receive an amount for reasonable expenses the court finds to have been necessarily incurred, in addition to reasonable attorneys' fees and costs. All such expenses, fees, and costs shall be awarded against the defendant.".

SEC. 4. Section 3730 of title 31, United States Code, is amended by adding at the end thereof the following new subsections:

"(e) Any employee who is discharged, demoted, suspended, threatened, harassed, or in any other manner discriminated against in the terms or conditions of such employment by his employer in whole or in part because of the exercise by such employee on behalf of himself or others of any option afforded by this Act, including investigation for, initiation of, testimony for, or assistance in an action filed or to be filed under this Act, shall be entitled to all relief necessary to make him whole. Such relief shall include reinstatement with full seniority rights, backpay with interest, and compensation for any special damages sustained as a result of the discrimination, including litigation costs and reasonable attorneys' fees. In addition, the employer shall be liable to such employee for twice the amount of back pay and special damages and, if appropriate under the circumstances, the court shall award punitive damages.

"(f) In any action brought under this section, or under section 3729, or 3731, the United States shall be required to prove all essential elements of the cause of action, including damages, by a preponderance of the evidence.

"(g) Notwithstanding any other provision of law, the Federal Rules of Criminal Procedure, or the Federal Rules of Evidence, a final judgment rendered in favor of the United States in any criminal proceeding charging fraud or false statements, whether upon a verdict after trial or upon a plea of guilty or nolo contendere, shall estop the defendant from denying the essential elements of the offense in any action brought by the United States pursuant to this section, or section 3729, or 3731.".

SEC. 5. (a) Paragraphs (A), (B), and (C) of Rule 6(e)(3) of the Federal Rules of Criminal Procedure are amended to read as follows:

"(A) Disclosure, otherwise prohibited by this rule, of matters occurring before the grand jury, other than its deliberations and the vote of any grand juror, may be made to—

"(i) any attorney for the government for use in the performance of such attorney's duty to enforce Federal criminal or civil law; and

"(ii) such government personnel (including personnel of a State or subdivision of a State) as are deemed necessary by an attorney for the government to assist such attorney in the performance of his duty to enforce Federal criminal law.

"(B) Any person to whom matters are disclosed under subparagraph (A)(ii) of this paragraph shall not utilize such grand jury material for any purpose other than assisting an attorney for the government in the performance of such attorney's duty to enforce Federal criminal or civil law. Such an attorney for the Government shall promptly provide the district court, before which the grand jury whose material has been so disclosed was impaneled, with the names of the persons to whom such disclosure has been made, and shall certify that the attorney has advised such persons of their obligation of secrecy under this rule.

"(C) Disclosure of matters occurring before the grand jury, otherwise prohibited by this rule, may also be made—

"(i) when directed to do so by a court, upon a showing of particularized need, preliminary to or in connection with a judicial proceeding;

"(ii) when permitted by a court at the request of the defendant, upon a showing that grounds may exist for a motion to dismiss the indictment because of matters occurring before the grand jury;

"(iii) when the disclosure is made by an attorney for the Government to another Federal grand jury;

"(iv) when permitted by a court at the request of an attorney for the Government, upon a showing that such matters may disclose a violation of State criminal law, to an appropriate official of a State or subdivision of a State for the purpose of enforcing such law; or

"(v) when so directed by a court upon a showing of substantial need, to personnel of any department or agency of the United States and any committee of Congress (a) when such personnel are deemed necessary to provide assistance to an attorney for the Government in the performance of such attorney's duty to enforce Federal civil law, or (b) for use in relation to any matter within the jurisdiction of such department, agency, or congressional committee.".

(b) The first sentence of paragraph (D) of Rule 6(e)(3) of the Federal Rules of Criminal Procedure is amended to read as follows:

"(D) A petition for disclosure pursuant to clause (i) or (v) of subsection (e)(3)(C) shall be filed in the district where the grand jury convened.".

SEC. 6. (a) Section 286 of title 18, United States Code, is amended by striking out "$10,000" and inserting in lieu thereof "$1,000,000".

(b) Section 287 of title 18, United States Code, is amended by striking out "$10,000, or imprisoned not more than five years" and inserting in lieu thereof "$1,000,000, or imprisoned for not more than ten years".

SEC. 7. This Act and the amendments made by this Act shall become effective upon the date of enactment.

I

99TH CONGRESS
1ST SESSION

H. R. 3334

Entitled the "False Claims Act Amendments of 1985".

IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 18, 1985

Mr. FISH (for himself, Mr. MOORHEAD, Mr. HYDE, Mr. SENSENBRENNER, Mr. DEWINE, and Mr. DANNEMEYER) introduced the following bill; which was referred to the Committee on the Judiciary

---

A BILL

Entitled the "False Claims Act Amendments of 1985".

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "False Claims Act Amendments of 1985".

SEC. 101. Section 3729 of title 31, United States Code is amended—

(1) by inserting "(a)" immediately before "A person";

(2) by striking out $2,000 and inserting in lieu thereof "$5,000" in subsection (a);

(3) by striking out "not a member of the armed forces of the United States" in subsection (a);

(4) by inserting "including consequential damages as defined in subsection (b)" after the phrase "an amount equal to 2 times the amount of damages" in subsection (a);

(5) by inserting after subparagraph (a)(6) the following:

"(7) knowingly makes, uses, or causes to be made or used, a false record or statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government.".

"(b)(1) Consequential damages as used in subsection (a) shall include damages which the United States would not have sustained but for—

"(i) the doing or commission of any of the acts prohibited by subsection (a); or

"(ii) having entered into or made any contract or grant as a result, in any material part, of any false statement.

"(2) Any credits to which the defendant establishes entitlement may be deducted from the amount payable under subsection (a) only after the damages sustained by the United States have been doubled as set forth in subsection (a).

"(3) If any portion of the damages sustained by the United States under subparagraph (1) is considered reasonably unforeseeable by the court, the court may reduce by not more than 25 percent the total amount of damages payable under subparagraph (1).

"(c) For purposes of this section, the terms 'knowing' and 'knowingly' mean the defendant—

"(1) had actual knowledge; or

"(2) has constructive knowledge in that the defendant had reason to know that the claims or statement was false or fictitious;

and no proof of intent to defraud or proof of any other element of a claim for fraud at common law is required.

"(d) For purposes of this section 'claim' includes any request or demand, whether under a contract or otherwise, for money or property which is made to a contractor, grantee, or other recipient if the Government provides any portion of the money or property which is requested or demanded, or if the Government will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested or demanded.".

"(e)(1) The Attorney General or his designee may apply for provisional relief to any district court having jurisdiction pursuant to section 3732 whenever he has reasonable cause to believe this section or section 3730, or 3731 may have been violated. If the court finds there is a reasonable likelihood that the United States will prevail after trail on the merits of its claims, the court shall enjoin the defendant from taking any action which the court, in the exercise of its discretion, finds reasonably likely to hinder or delay the United States in the collection of any judgment which may be obtained in such action.

"(2) In addition, the court may from time to time make such other orders as it deems appropriate, including but not limited to, requiring the defendant to post security for judgment, to seek the prior approval of the court before making any transfer without an adequate and full consideration, paying an antecedent debt which has matured more than 30 days prior to payment, or otherwise engaging in any transaction not in the usual and regular course of the defendant's business. Except as provided in this section, such application and proceedings by the Attorney General shall be governed by rule 65 of the Federal Rules of Civil Procedure.".

Sec. 102. Section 3730 of title 31, United States Code is amended—

(1) by striking out "$2,000" in subsection (a) and inserting in lieu thereof "$5,000".

(2) by striking out "The district courts of the United States have jurisdiction of the action. Trial is in the judicial district within whose jurisdictional limits

the person charged with a violation is found or the violation occurs." in subsection (b)(1).

SEC. 103. Section 3731 of title 31, United States Code, is amended—

(1) by striking out the period at the end of subsection (b) and inserting "or within three years from the date when facts material to the right of action are known or reasonably should have been known by the official within the Department of Justice charged with responsibility to act in the circumstances, whichever occurs last.".

(2) by inserting after subsection (b), the following new subsections:

"(c) In any action brought under this section or section 3729, 3730, 3732, or 3733, the United States shall be required to prove all essential elements of the cause of action, including damages, by a preponderance of the evidence.

"(d) Notwithstanding any contrary provision of law, the Federal Rules of Criminal Procedure, or the Federal Rules of Evidence, a final judgment rendered in favor of the United States in any criminal proceeding charging fraud or false statements, whether upon a verdict after trial or upon a plea of guilty or nolo contendere, shall estop the defendant from denying the essential elements of the offense in any action brought by the United States pursuant to this section or section 3729, 3730, 3732, or 3733.".

Sec. 104. Title 31 is amended by adding the following new section:

"§ 3732. False claims jurisdiction

"(a) The district courts of the United States and for Puerto Rico, the Virgin Islands, Guam, and any territory or possession of the United States, shall have jurisdiction over any action commenced by the United States under this section, or under section 3729, 3730, 3731, or 3733 and venue of any such action shall be proper in any district in which any defendant, or in the case of multiple defendants, any one defendant can be found, resides, transacts business, or in which any act proscribed by such sections is alleged by the United States to have occurred. A summons as required by the Federal Rules of Civil Procedure shall be issued by the district court and served at any place within the United States, Puerto Rico, the Virgin Islands, Guam, any territory or possession of the United States, or in any foreign country.

"(b) The United States Court of Claims shall also have jurisdiction of any such action if the action is asserted by way of counterclaim by the United States. The United States may join as additional parties in such counterclaim all persons who may be jointly and severally liable with such party against whom a counterclaim is asserted by reason of having violated this section, or section 3729, 3730, 3731, or 3733, except that no cross-claims or third-party claims shall be asserted among such additional parties unless such claims are otherwise within the jurisdiction of the United States Court of Claims.".

SEC. 105. Title 31 is amended by adding the following new section:

"§ 3733. Civil investigative demands

"(a) DEFINITIONS.—For purposes of this section, the term—

"(1) 'False Claims Act law' means—

"(A) this section and sections 3729 through 3731 of this title (96 Stat. 978–979), commonly known as the False Claims Act; and

"(B) any Act of Congress enacted after this section which prohibits, or makes available to the United States in any court of the United States any civil remedy with respect to any false claim, bribery, or corruption of any officer or employee of the United States;

"(2) 'False Claims Act investigation' means any inquiry conducted by any False Claims Act investigator for the purpose of ascertaining whether any person is or has been engaged in any violation of a False Claims Act law;

"(3) 'False Claims Act investigator' means any attorney or investigator employed by the Department of Justice who is charged with the duty of enforcing or carrying into effect any False Claims Act law or any officer or employee of the United States acting under direction and supervision of such attorney or investigator in connection with a False Claims Act investigation;

"(4) 'person' means any natural person, partnership, corporation, association, or other legal entity, including any State or political subdivision;

"(5) 'documentary material' includes the original or any copy of any book, record, report, memorandum, paper, communication, tabulation, chart, or other document, or data compilations stored in or accessible through computer or other information retrieval systems, together with instructions and all other materials necessary to use or interpret such data compilations, and any product or discovery;

"(6) 'custodian' means the custodian, or any deputy custodian, designated by the Attorney General; and

"(7) 'product of discovery' includes without limitation the original or duplicate of any deposition, interrogatory, document, thing, result of the inspection of land or other property, examination, or admission obtained by any method of discovery in any judicial litigation or administrative litigation of an adversarial nature; any digest, analysis, selection, compilation, or any derivation thereof; and any index or manner of access thereto.

"(b) Civil Investigative Demands.—

"(1) Issuance; service; production of material; testimony.—Whenever the Attorney General, the Deputy Attorney General, or an Assistant Attorney General has reason to believe that any person may be in possession, custody, or control of any documentary material, or may have any information relevant to a False Claims Act investigation, he may, prior to the institution of a civil proceeding, issue in writing and cause to be served upon such person, a civil investigative demand requiring such person to produce such documentary material for inspection and copying, to answer in writing written interrogatories, to give oral testimony concerning documentary material or information, or to furnish any combination of such material, answers, or testimony. Whenever a civil investigative demand is an express demand for any product of discovery, the Attorney General, the Deputy Attorney General or an Assistant Attorney General shall cause to be served, in any manner authorized by this section, a copy of such demand upon the person from whom the discovery was obtained and notify the person to whom such demand is issued of the date on which such copy was served.

"(2) CONTENTS; RETURN DATE FOR DEMAND.—

"(A) Each such demand shall state the nature of the conduct constituting the alleged violation of a False Claims Act law which is under investigation, and the applicable provision of law.

"(B) If such demand is for production of documentary material, the demand shall—

"(i) describe each class of documentary material to be produced with such definiteness and certainty as to permit such material to be fairly identified;

"(ii) prescribe a return date for each such class which will provide a reasonable period of time within which the material so demanded may be assembled and made available for inspection, and copying; and

"(iii) identify the False Claims Act investigator to whom such material shall be made available.

"(C) If such demand is for answers to written interrogatories, the demand shall—

"(i) set forth with definiteness and certainty the written interrogatories to be answered;

"(ii) prescribe dates at which time answers to written interrogatories shall be submitted; and

"(iii) identify the False Claims Act investigator to whom such answers shall be submitted.

"(D) If such demand is for the giving of oral testimony, the demand shall—

"(i) prescribe a date, time, and place at which oral testimony shall be commenced; and

"(ii) identify a False Claims Act investigator who shall conduct the examination and the custodian to whom the transcript of such examination shall be submitted.

Any such demand which is an express demand for any product of discovery shall not be returned or returnable until twenty days after a copy of such demand has been served upon the person from whom the discovery was obtained.

"(c) PROTECTED MATERIAL OR INFORMATION.—

"(1) No such demand shall require the production of any documentary material, the submission of any answers to written interrogatories, or the giving of any oral testimony if such material, answers, or testimony would be protected from disclosure under—

"(A) the standards applicable to subpoenas or subpoenas duces tecum issued by a court of the United States to aid in a grand jury investigation; or

"(B) the standards applicable to discovery requests under the Federal Rules of Civil Procedure, to the extent that the application of such standards to any such demand is appropriate and consistent with the provisions and purposes of this section and sections 3729 through 3731.

"(2) Any such demand which is an express demand for any product of discovery supersedes any inconsistent order, rule, or provision of law (other than this section) preventing or restraining disclosure of such product of discovery to any person. Disclosure of any product of discovery pursuant to any such express demand does not constitute a waiver of any right or privilege which may be invoked to resist discovery of trail preparation materials to which the person making such disclosure may be entitled.

"(d) SERVICE: JURISDICTION.—

"(1) Any such demand may be served by any False Claims Act investigator, or by any United States Marshal or Deputy Marshal, at any place within the United States.

"(2) Any such demand or any petition filed under subsection (k) may be served upon any person who is not found within the United States, in such manner as the Federal Rules of Civil Procedures prescribe for service in a foreign country. To the extent that the courts of the United States can assert jurisdiction over such person consistent with due process, the United States District Court for the District of Columbia shall have the same jurisdiction to take any action respecting compliance with this section by such person that such court would have if such person were personally within the jurisdiction of such court.

"(e) SERVICE UPON LEGAL ENTITIES AND NATURAL PERSONS.—

"(1) Service of any such demand or of any petition filed under subsection (k) may be made upon a partnership, corporation, association, or other legal entity by—

"(A) delivering an executed copy thereof to any partner, executive officer, managing agent, or general agent thereof, or to any agent thereof authorized by appointment or by law to receive service of process on behalf of such partnership, corporation, association, or entity;

"(B) delivering an executed copy thereof to the principal office or place of business of the partnership, corporation, or entity to be served, or

"(C) depositing such copy in the United States mails, by registered or certified mail, return receipt requested, addressed to such partnership, corporation, association, or entity at its principal office or place of business.

"(2) Service of any such demand or of any petition filed under subsection (k) may be made upon any natural person by—

"(A) delivering an executed copy thereof to the person to be served; or

"(B) depositing such copy in the United States mails by registered or certified mail, return receipt requested, addressed to such person at his residence or principal office or place of business.

"(f) PROOF OF SERVICE.—A verified return by the individual serving any such demand or petition setting forth the manner of such service shall be proof of such service. In the case of service by registered or certified mail, such return shall be accompanied by the return post office receipt of delivery of such demand.

"(g) SWORN CERTIFICATES.—The production of documentary material in response to a demand served pursuant to this section shall be made under a sworn certificate, in such form as the demand designates, by the person, if a natural person, to whom the demand is directed or, if not a natural person, by a person having knowledge of the facts and circumstances relating to such production and authorized to act on behalf of such person. The certificate shall state that all of the documentary material required by the demand and in the possession, custody, or control of the person to whom the demand is directed has been produced and made available to the custodian.

"(h) INTERROGATORIES.—Each interrogatory in a demand served pursuant to this section shall be answered separately and fully in writing under oath unless it is objected to, in which event the reasons for the objection shall be stated in lieu of any answer, and it shall be submitted under a sworn certificate, in such form as the demand designates, by the person, if a natural person, to whom the demand is directed or, if not a natural person, by a person or person responsible for answering each interrogatory. The certificate shall state that all information required by the demand and in the possession, custody, control, or knowledge of the person to whom the demand is directed has been submitted. To the extent that any materials are not furnished, they shall be identified and reasons set forth with particularity for each.

"(i) ORAL EXAMINATIONS.—

"(1) The examination of any person pursuant to a demand for oral testimony served under this section shall be taken before an officer authorized to administer oaths and affirmations by the laws of the United States or of the place where the examination is held. The officer before whom the testimony is to be taken shall put the witness on oath or affirmation and shall personally, or by someone acting under his direction and in his presence, record the testimony of the witness. The testimony shall be taken stenographically and transcribed. When the testimony is fully transcribed, the officer before whom the testimony is taken shall promptly transmit a copy of the transcript of the testimony to the custodian. This subsection shall not preclude the taking of testimony by any means authorized by, and in a manner consistent with, the Federal Rules of Civil Procedure.

"(2) The False Claims Act investigator conducting the examination shall exclude from the place where the examination is held all other persons except the person being examined, his counsel, the officer before whom the testimony is to be taken, and any other stenographer taking such testimony.

"(3) The oral testimony of any person taken pursuant to a demand served under this section shall be taken in the judicial district of the United States within which such person resides, is found, or transacts business, or in such other place as may be agreed upon by the False Claims Act investigator conducting the examination and such person.

"(4) When the testimony is fully transcribed, the False Claims Act investigator or the officer shall afford the witness, who may be accompanied by counsel, a reasonable opportunity to examine the transcript and the transcript shall be read to or by the witness, unless such examination and reading are waived by the witness. Any changes in form or substance which the witness desires to make shall be entered and identified upon the transcript by the officer or the False Claims Act investigator with a statement of the reasons given by the witness for making such changes. The transcript shall then be signed by the witness, unless the witness in writing waives the signing, is ill, cannot be found, or refuses to sign. If the transcript is not signed by the witness within 30 days of his being afforded a reasonable opportunity to examine it, the officer or the False

Claims Act investigator shall sign it and state on the record the fact of the waiver, illness, absence of the witness, or the refusal to sign, together with the reason, if any, given therefor. A refusal to sign or an unreasonable absence shall be deemed to be an acknowledgment of its accuracy and an affirmation of its contents.

"(5) The officer shall certify on the transcript that the witness was sworn by him and that the transcript is a true record of the testimony given by the witness, and the officer or False Claims Act investigator shall promptly deliver it or send it by registered or certified mail to the custodian.

"(6) Upon payment of reasonable charges therefor, the False Claims Act investigator shall furnish a copy of the transcript to the witness only, except that the Attorney General, the Deputy Attorney General, or an Assistant Attorney General may, for good cause, limit such witness to inspection of the official transcript of his testimony.

"(7)(A) Any person compelled to appear under a demand for oral testimony pursuant to this section may be accompanied, represented, and advised by counsel. Counsel may advise such person, in confidence, with respect to any question asked of such person. Such person or counsel may object on the record to any question, in whole or in part, and shall briefly state for the record the reason for the objection. An objection may be properly made, received, and entered upon the record when it is claimed that such person is entitled to refuse to answer the question on grounds of any constitutional or other legal right or privilege, including the privilege against self-incrimination. Such person shall not otherwise object to or refuse to answer any question, and shall not by himself or through counsel otherwise interrupt the oral examination. If such person refuses to answer any question, the False Claims Act investigator conducting the examination may petition the district court of the United States pursuant to subsection (k)(1) for an order compelling such person to answer such question.

"(B) If such person refuses to answer any question on the grounds of the privilege against self-incrimination, the testimony of such person may be compelled in accordance with the provisions of part V of title 18, United States Code.

"(8) Any person appearing for oral examination pursuant to a demand served under this section shall be entitled to the same fees and mileage which are paid to witnesses in the district courts of the United States.

"(j) CUSTODIANS OF DOCUMENTS, ANSWERS AND TRANSCRIPTS.—

"(1) DESIGNATION.—The Attorney General, or his authorized designee shall designate a False Claims Act investigator to serve as custodian of documentary material, answers to interrogatories, and transcripts of oral testimony received under this section, and such additional False Claims Act investigators as he shall determine from time to time to be necessary to serve as deputies to such officer.

"(2) PRODUCTION OF MATERIALS.—Any person upon whom any demand under subsection (b)(1) for the production of documentary material has been served shall make such material available for inspection and copying to the False Claims Act investigator designated therein at the principal place of business of such person, or at such other place as such False Claims Act investigator and such person thereafter may agree and prescribe in writing, or as the court may direct pursuant to subsection (k)(1) on the return date specified in such demand, or on such later date as such custodian may prescribe in writing. Such person may, upon written agreement between such person and the custodian, substitute copies for originals of all or any part of such material.

"(3) RESPONSIBILITY FOR MATERIALS; DISCLOSURE.—

"(A) The False Claims Act investigator to whom any documentary material, answers to interrogatories, or transcripts of oral testimony are delivered shall taken physical possession thereof, and shall transmit them to the custodian who shall be responsible for the use made thereof and for the return of documentary material pursuant to this section.

"(B) The custodian may cause the preparation of such copies of such documentary material, answers to interrogatories, or transcripts of oral testimony as may be required for official use by any authorized official or employee of the Department of Justice or any authorized officer or employee of the United States acting under the direction and supervision of an attorney or investigator of the Department of Justice in connection with any False Claims Act investigation, under regulations promulgated by the Attorney General. Notwithstanding subparagraph (C) of this subsection, such material, answers, and transcripts may be used by any such person in connection with the taking of oral testimony pursuant to this section.

"(C) Except as otherwise provided in this section, while in the possession of the custodian, no documentary material, answers to interrogatories, or transcripts of oral testimony, or copies thereof, so produced shall be available for examination, without the consent of the person who produced such material, answers, or transcripts, and, in the case of any product of discovery produced pursuant to an express demand for such material, of the person from whom the discovery was obtained, by any individual other than an authorized official or employee of the Department of Justice, or an authorized officer or employee of the United States acting under the direction and supervision of an attorney or investigator of the Department of Justice in connection with any False Claims Act investigation. Nothing in this section is intended to prevent disclosure to either body of the Congress or to any auhorized committee or subcommittee thereof, or to any other agency of the United States for use by such agency in furtherance of its statutory responsibilities.

"(D) While in the possession of the custodian and under such reasonable terms and conditions as the Attorney General shall prescribe—

"(i) documentary material and answers to interrogatories shall be available for examination by the person who produced such material or answers, or by an authorized representative of such person; and

"(ii) transcripts of oral testimony shall be available for examination by the person who produced such testimony, or his counsel.

"(4) Whenever any attorney of the Department of Justice has been designated to appear before any court, grand jury, or Federal administrative or regulatory agency in any case or proceeding, the custodian of any documentary material, answers to interrogatories, or transcripts of oral testimony may deliver to such attorney such material, answers, or transcripts for official use in connection with any such case, grand jury, or proceeding as such attorney determines to be required. Upon the completion of any such case, grand jury, or proceeding, such attorney shall return to the custodian any such material, answers, or transcripts so delivered which have not passed into the control of such court, grand jury, or agency through the introduction thereof into the record of such case or proceeding.

"(5) If any documentary material has been produced in the course of any False Claims Act investigation by any person pursuant to a demand under this section, and—

"(A) any case or proceeding before any court or grand jury arising out of such investigation, or any proceeding before any Federal administrative or regulatory agency involing such material, has been completed, or

"(B) no case or proceeding in which such material may be used has been commenced within a reasonable time after completion of the examination and analysis of all documentary material and other information assembled in the course of such investigation,

the custodian shall, upon written request of the person who produced such material, return to such person any such material (other than copies thereof furnished to the custodian pursuant to paragraph (2) of this subsection or made by the Department of Justice pursuant to paragraph (3)(B) of this subsection) which has not passed into the control of any court, grand jury, or agency through the introduction thereof into the record of such case or proceedings.

"(6) APPOINTMENT OF SUCCESSOR CUSTODIANS.—In the event of the death, disability, or separation from service in the Department of Justice of the custodian of any documentary material, answers to interrogatories, or transcripts of oral testimony produced under any demand issued pursuant to this section, or of the official relief of such custodian from responsibility for the custody and control of such material, answers or transcripts, the Attorney General or his authorized designee shall promptly (A) designate another False Claims Act investigator to serve as custodian of such material, answers, or transcripts, and (B) transmit in writing to the person who produced such material, answers, or testimony notice as to the identity and address of the successor so designated. Any successor designated under this subsection shall have, with regard to such material, answers or transcripts, all duties and responsibilities imposed by this Act upon his predecessor in office with regard thereto, except that he shall not be held responsible for any default or dereliction which occurred prior to his designation.

"(k) JUDICIAL PROCEEDINGS.—

"(1) PETITION FOR ENFORCEMENT; VENUE.—Whenever any person fails to comply with any civil investigative demand served upon him under subsection (b) or whenever satisfactory copying or reproduction of any such material cannot be done and such person refuses to surrender such material, the Attorney General, through such officers or attorneys as he may designate, may file in the district court of the United States for any judicial district in which such person resides, is found, or transacts business, and serve upon such person a petition for an order of such court for the enforcement of this section.

"(2) PETITION FOR ORDER MODIFYING OR SETTING ASIDE DEMAND; TIME FOR PETITION; SUSPENSION OF TIME ALLOWED FOR COMPLIANCE WITH DEMAND; GROUNDS FOR RELIEF.—

"(A) Within 20 days after the service of any such demand upon any person, or at any time before the return date specified in the demand, whichever period is shorter, or within such period exceeding 20 days after service or in excess of such return date as may be prescribed in writing, subsequent to service, by any False Claims Act investigator named in the demand, such person may file, in the district court of the United States for the judicial district within which such person resides, is found, or transacts business, and serve upon such False Claims Act investigator a petition for an order of such court, modifying or setting aside such demand. In the case of a petition addressed to an express demand for any product of discovery, a petition to modify or set aside such demand may be brought only in the district court of the United States for the judicial district in which the proceeding in which such discovery was obtained is or was last pending.

"(B) The time allowed for compliance with the demand, in whole or in part, as deemed proper and ordered by the court shall not run during the pendency of such petition in the court, except that such person shall comply with any portions of the demand not sought to be modified or set aside. Such petition shall specify each ground upon which the petitioner relies in seeking such relief, and may be based upon any failure of such demand to comply with the provisions of this section or upon any constitutional or other legal right or privilege of such person.

"(3) PETITION FOR ORDER MODIFYING OR SETTING ASIDE DEMAND FOR PRODUCTION OF DISCOV-

ERY; GROUNDS FOR RELIEF; STAY OF COMPLIANCE: SUSPENSION OF TIME ALLOWED FOR COMPLIANCE WITH DEMAND.—Within twenty days after the service of any express demand for any product of discovery upon, or at any time before, the return date specified in the demand, whichever period is shorter, or within such period exceeding twenty days after service or in excess of such return date as may be prescribed in writing, subsequent to service, by any False Claims Act investigator named in the demand, the person from whom such discovery was obtained may file, in the district court of the United States for the judicial district in which the proceeding in which such discovery was obtained is or was last pending, and serve upon any False Claims Act investigator named in the demand and upon the recipient of the demand, a petition for an order of such court modifying or setting aside those portions of the demand requiring production of any such product of discovery. Such petition shall specify each ground upon which the petitioner relies in seeking such relief and may be based upon any failure of such portions of the demand to comply with the provisions of this section, or upon any constitutional or other legal right or privilege of the petitioner. During the pendency of such petition, the court may stay, as it deems proper, compliance with the demand and the running of the time allowed for compliance with the demand.

"(4) PETITION FOR ORDER REQUIRING PERFORMANCE BY CUSTODIAN OF DUTIES; VENUE.—At any time during which any custodian is in custody or control of any documentary material, answers to interrogatories delivered, or transcripts of oral testimony given by any person in compliance with any such demand, such person, and in the case of an express demand for any product of discovery, the person from whom such discovery was obtained, may file, in the district court of the United States for the judicial district within which the office of such custodian is situated, and serve upon such custodian, a petition for an order of such court requiring the performance by such custodian of any duty imposed upon him by this section.

"(5) JURISDICTION; APPEAL; CONTEMPTS.—Whenever any petition is filed in any district court of the United States under this section, such court shall have jurisdiction to hear and determine the matter so presented, and to enter such order or orders as may be required to carry into effect the provisions of this section. Any final order so entered shall be subject to appeal pursuant to section 1291 of title 28, United States Code. Any disobedience of any final order enetered under this section by any court shall be punished as a contempt thereof.

"(6) APPLICABILITY OF FEDERAL RULES OF CIVIL PROCEDURE.—To the extent that such rules may have application and are not inconsistent with the provisions of this section, the Federal Rules of Civil Procedure shall apply to any petition under this subsection.

"(7) DISCLOSURE EXEMPTION.—Any documentary material, answers to written interrogatories, or oral testimony provided pursuant to any demand issued under this section and sections 3729 through 3731 shall be exempt from disclosure under section 552 of title 5, United States Code.".

○

I

99TH CONGRESS
1ST SESSION

H. R. 3335

Entitled the "Program Fraud Civil Penalties Act of 1985".

IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 18, 1985

Mr. FISH (for himself, Mr. MOORHEAD, Mr. HYDE, Mr. SENSENBRENNER, Mr. DEWINE, Mr. DANNEMEYER, and Mr. COBLE) introduced the following bill; which was referred to the Committee on the Judiciary

---

A BILL

Entitled the "Program Fraud Civil Penalties Act of 1985".

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Program Fraud Civil Penalties Act of 1985".

SEC. 101. (a) Title 5 of the United States Code is amended by inserting after chapter 7 the following new chapter:

"CHAPTER 8—ADMINISTRATIVE PENALTIES AND ASSESSMENTS FOR FALSE CLAIMS AND STATEMENTS

"Sec.
"801. Definitions.
"802. False claims and statements; liability.
"803. Hearing and determinations.

"804. Subpoena authority.
"805. Judicial review.
"806. Collection of civil penalties and assessments.
"807. Limitations.
"808. Regulations.
"809. Right to setoff.

"§ 801. Definitions

"(a) For purposes of this chapter—

"(1) 'authority' means—

"(A) an executive department;

"(B) a military department;

"(C) an establishment (as such term is defined in section 11(2) of the Inspector General Act of 1978) which is not an executive department; and

"(D) the United States Postal Service;

"(2) 'authority head' means—

"(A) the head of an authority, or

"(B) an official or employee of the authority designated, in regulations promulgated by the head of the authority, to act on behalf of the head of the authority;

"(3) 'claim' means any—

"(A) request or demand made to an authority for property, services, or money (including money representing grants, loans, insurance, or benefits); or

"(B) request or demand made to a recipient of property, services, or money from an authority or to a party to a contract with an authority—

"(i) for property or services if the United States—

"(I) provided such property or services;

"(II) provided any portion of the funds for the purchase of such property or services; or

"(III) will reimburse such recipient or party for the purchase of such property or services; or

"(ii) for the payment of money (including money representing grants, loans, insurance, or benefits) if the United States—

"(I) provided any portion of the money requested or demanded; or

"(II) will reimburse such recipient for any portion of the money paid on such request or demand; or

"(C) statement made to conceal, avoid, or decrease an obligation to pay, transmit, or account for, money or property to the authority;

"(4) 'statement' includes any written representation, certification, document record, or accounting or bookkeeping entry—

"(A) with respect to a claim; or

"(B) with respect to—

"(i) a contract with, or a bid or proposal for a contract with;

"(ii) a grant, loan or benefit from;

"(iii) an application for insurance from; or

"(iv) an application for employment with, an authority, or any State, political subdivision of a State, or other party acting on behalf of, or based upon the credit or guarantee of, an authority;

"(5) 'person' means any individual, partnership, corporation, association, or private organization;

"(6) 'investigating official' means—

"(A) in the case of an authority in which an Office of Inspector General is established by the Inspector General Act of 1978 or by any other Federal law, the Inspector General of that authority;

"(B) in the case of an authority in which an Office of Inspector General is not established by the Inspector General Act of 1978 or by any other Federal law, any officer or employee of the authority designated by the authority head to conduct investigations under section 803(a)(1) of this title; or

“(C) in the case of a military department, the Inspector General of the Department of Defense or an element within the military department designated by him;

“(7) ‘reviewing official’ means any officer or employee of an authority—

“(A) who is designated by the authority head to make the determination required in section 803(a)(2) of this title; and

“(B) who, if a member of the armed forces on active duty, is serving in grade 0–7 or above or, if a civilian, is serving in a position for which the rate of basic pay is not less than the minimum rate of basic pay for grade GS–16 or above under the General Schedule; and

“(8) ‘hearing examiner’ means an administrative law judge or another official designated by the authority head—

“(A) who, if a member of the armed forces on active duty, is serving in grade 0–7 or above or, if a civilian, is serving in a position for which the rate of basic pay is not less than the minimum rate of basic pay for grade GS–15 or above under the General Schedule; and

"(B) who shall be personally and organizationally independent of the investigating official, the official pleading the authority's case, and the office from where the matter under review arose.

"(b) For purposes of paragraph (3) of subsection (a)—

"(1) each voucher, invoice, claim form, or other individual request or demand for property, services, or money constitutes a separate claim whether made, presented, or submitted separately or together with other claims;

"(2) each request or demand for property, services, or money constitutes a claim regardless of whether such property, services, or money is actually delivered or paid; and

"(3) a claim shall be considered made, presented, or submitted to an authority, recipient, or party when such claim is made to an agent, fiscal intermediary, or other entity, including any State or political subdivision thereof, acting for or on behalf of such authority, recipient, or party.

"(c) For purposes of paragraph (4) subsection (a)—

"(1) each written representation or certification constitutes a separate statement whether made, presented, or submitted separately or together with other statements; and

"(2) a statement shall be considered made, presented, or submitted to an authority although such statement is actually made to an agent, fiscal intermediary, or other entity, including any State or political subdivision thereof, acting for or on behalf of such authority.

"(d) For purposes of sections 803 and 804, with respect to a military department, 'authority head' means the Secretary of Defense.

"§ 802. False claims and statements; liability

"(a)(1) Any person who, on or after the effective date of this chapter, makes, presents, or submits, or causes to be made, presented, or submitted, a claim that the person knows or has reason to know—

"(A) is false, fictitious or fraudulent;

"(B) includes or is supported by any statement which violates paragraph (2) of this subsection; or

"(C) is for payment for the provision of property or services which the person has not provided as claimed, shall be subject to, in addition to any other penalty that may be prescribed by law, a civil penalty of not more than $5,000 for each such claim. Such person shall also be subject to an assessment, in lieu of damages sustained by the United States because of such claim, of not more than twice the amount of money or the value of property or services falsely, fictitiously, or fraudulently requested or demanded in such claim.

"(2) Any person who, on or after the effective date of this chapter makes, presents, or submits, or causes to be made, presented, or submitted, a statement that the person knows or has reason to know—

"(A) asserts a material fact which is false, fictitious, or fraudulent; or

"(B)(i) omits a material fact,

"(ii) as a result of such omission, such statement is false, fictitious, or fraudulant, and

"(iii) the person making, presenting, or submitting such statement has a duty to include such material fact in the statement,

shall be subject to, in addition to any other penalty that may be prescribed by law, a civil penalty of not more than $5,000 for each such statement.

"(b)(1) Except as provided in paragraph (2) of this subsection, a determination of—

"(A) adequate evidence to believe that a person is liable under section 803(a)(2) of this title, or

"(B) liability under section 803 of this title, may provide the authority with grounds for commencing any administrative or contractual action against such person which is authorized by law and which is in addition to any action against such person under this chapter.

"(2) A determination referred to in paragraph (1) of this subsection may be used by the authority, but shall not require such authority, to commence any administrative or contractual action which is authorized by law.

"§ 803. Hearing and determinations

"(a)(1) The investigating official of an authority may investigate allegations that a person is liable under section 802 of this title and shall report the findings and conclusions of such investigation to the reviewing official of the authority. Nothing in this section shall alter existing responsibilities under section 4(d) of the Inspector General Act of 1978 of an investigating official to immediately report any criminal violations to the Attorney General.

"(2) If the reviewing official of an authority determines, based upon the report of the investigating official under paragraph (1) of this subsection, that there is adequate evidence to believe that a person is liable under section 802 of this title, the reviewing official may, in accordance with the provisions of subsections (b) and (c) of this section, refer the allegations of such liability to a hearing examiner of such authority for a hearing.

"(b)(1) Prior to referring allegations of liability to a hearing examiner under paragraph (2) of subsection (a), the reviewing official of an authority shall transmit to the Attorney General a written notice of the intention of such official to refer such allegations and a statement of the reasons for such intention.

"(2) A reviewing official may refer allegations of liability to a hearing examiner under paragraph (2) of subsection (a) if—

"(A) the Attorney General or his designee approves the referral of such allegations; or

"(B) the Attorney General or his designee takes no action to disapprove the referral of such allegations within—

"(i) ninety days after the date on which the Attorney General receives the notice required by paragraph (1) of this subsection; or

"(ii) such period as may be provided in a memorandum of understanding entered into by the authority head and the Attorney General with respect to such allegations.

"(3) A reviewing official shall not refer allegations to a hearing examiner under paragraph (2) of subsection (a) if the Attorney General or an Assistant Attorney General designated by the Attorney General transmits a written statement to the reviewing official which specifies that the Attorney General or such Assistant Attorney General disapproves the referral of such allegations and states the reasons for such disapproval.

"(4) If the Attorney General or an Assistant Attorney General designated by the Attorney General transmits to an authority head a written finding that the continuation of any hearing under section 803 of this title may adversely affect any pending or potential criminal or civil action related to an alleged false, fictitious, or fraudulent claim or statement under consideration in such hearing, such hearing shall be immediately stayed and may be resumed only upon written authorization of the Attorney General.

"(c) No allegations of liability under section 802 of this title with respect to any claim or statement, made, presented, or submitted by any person shall be referred to a hearing examiner under paragraph (2) of subsection (a) if the reviewing official determines that the amount of money or the value of property or services falsely, fictitiously, or fraudulently requested or demanded in such claim or statement exceeds $100,000.

"(d) A reviewing official shall commence a hearing under subsection (e) of this section by mailing by registered or certified mail, or be delivery, of a notice which complies with the provisions of paragraph (2)(A) of subsection (f) to the person alleged to be liable under section 802 of this title.

"(e) The hearing examiner shall conduct a hearing on the record regarding any allegation referred to the hearing examiner by the reviewing official pursuant to subsection (a) of this section to determine—

"(1) the liability of a person under section 802 of this title; and

"(2) the amount of any penalty and assessment to be imposed on such person.

Any such determination shall be based on the preponderance of the evidence.

"(f)(1) Each hearing under subsection (e) of this section shall be conducted in accordance with—

"(A) the provisions of subchapter II of chapter 5 of this title (to the extent that such provisions are not inconsistent with the provisions of this chapter); or

"(B) procedures promulgated by the authority head under paragraph (2) of this subsection;

Provided however, That if the hearing examiner to whom the allegations are referred is an administrative law judge, the hearing shall be conducted in accordance with subchapter II of chapter 5.

"(2) An authority head shall by regulation promulgate procedures for the conduct of hearings under this chapter. Such procedures shall include:

"(A) The provision of written notice of the hearing to any person alleged to be liable under section 802 of this title, including written notice of—

"(i) the time, place, and nature of the hearing;

"(ii) the legal authority and jurisdiction under which the hearing is to be held;

"(iii) the matters of fact and law to be asserted; and

"(iv) a description of the procedures for the conduct of hearing established under this paragraph or established under subchapter II of chapter 5 of this title, as the case may be.

"(B) The provision to any person alleged to be liable under section 802 of this title of opportunities for the submission of facts, arguments, offers of settlement, or proposals of adjustment when time, the nature of the hearing, and the public interest permit.

"(C) Procedures to ensure that the hearing examiner shall not, except to the extent required for the disposition of ex parte matters as authorized by law—

"(i) consult a person or party on a fact in issue, unless on notice and opportunity for all parties to the hearing to participate; or

"(ii) be responsible to or subject to the supervision or direction of the investigating official or the reviewing official.

"(D) Procedures to ensure that the investigating official and the reviewing official do not participate or advise in the decision required under subsection (g) of this section or the review of the decision by the authority head under subsection (h) of this section, except as provided in subsection (i) of this section.

"(E) The provision to any person alleged to be liable under section 802 of this title of opportunities to present such person's case through oral or documentary evidence, to submit rebuttal evidence, and to conduct such crossexamination as may be required for a full and true disclosure of the facts.

"(F) Procedures to permit any person alleged to be liable under section 802 of this title to be accompanied, represented, and advised by counsel or such other qualified representative as the authority head may specify in such regulations.

"(G) Procedures to ensure that the hearing is conducted in an impartial manner, including procedures to—

"(i) permit the hearing examiner to at any time disqualify himself;

"(ii) permit the filing, in good faith, of a timely and sufficient affidavit of personal bias or other disqualification of a hearing examiner or reviewing official; and

"(iii) provide for the determination by the authority head of a matter filed pursuant to clause (ii) of this subparagraph as a part of the record and decision in the hearing.

"(g) The hearing examiner shall issue a written decision, including findings and determinations, after the conclusion of the hearing. The hearing examiner shall promptly send to each party to the hearing a copy of such decision and a statement describing the right of any person determined to be liable under section 802 of this title to appeal the decision of the hearing examiner to the authority head under paragraph (2) of subsection (h).

"(h)(1) Except as provided in paragraph (2) of this subsection and section 805 of this title, the decision, including

BEST

the findings and determinations, of the hearing examiner issued under subsection (g) of this section are final.

"(2) Within thirty days after the hearing examiner issues a decision under subsection (g) of this section, any person determined in such decision to be liable under section 802 of this title may appeal such decision to the authority head. The authority head may affirm, reduce, compromise, remand, or settle any penalty and assessment determined by the hearing examiner pursuant to this section. The authority head shall promptly send to each party to the appeal a copy of the decision of the authority head and a statement describing the right of any person determined to be liable under section 802 of this title to judicial review under section 805 of this title.

"(i) Upon completion of the procedures required by section 803(b)(2), the reviewing official shall have the exclusive authority to compromise or settle any allegations of liability under section 802 of this title against a person without the consent of the hearing examiner at any time prior to the date in which the hearing examiner issues a decision under subsection (g) of this section.

"§ 804. Subpoena authority

"(a) For the purposes of an investigation under section 803(a) of this title, an investigating official is authorized—

"(1) to administer oaths or affirmations; or

"(2) to require by subpoena the production of all information, documents, reports, answers, records, accounts, papers, and other data not otherwise reasonably available to the authority.

"(b) For the purposes of conducting a hearing under section 803(e) of this title, a hearing examiner is authorized—

"(1) to administer oaths or affirmations; and

"(2) to require by subpoena the attendance and testimony of witnesses and the production of all information, documents, reports, answers, records, accounts, papers, and other data and documentary evidence which the hearing examiner considers relevant and material to the hearing.

"(c) In the case of contumacy or refusal to obey a subpoena issued pursuant to subsection (a) or (b) of this section, an investigating official or a hearing examiner, as the case may be, may invoke the aid of any district court of the United States in the district in which such investigation or hearing is being conducted, or where the person receiving the subpoena resides or conducts business. The district courts of the United States shall have jurisdiction to issue an appropriate order for the enforcement of any such subpoena. Any failure to obey such order of the court is punishable by such court as contempt.

BE

"§ 805. Judicial review

"(a) Unless a petition is filed under this section, a determination of liability under section 803 of this title shall be final and shall not be subject to judicial review.

"(b)(1) Any person for whom a determination of liability under section 802 of this title has been made pursuant to section 803 of this title may obtain review of such determination in the United States Court of Appeals for the circuit in which such person resides or in which the claim or statement upon which the determination of liability is based was made, presented, or submitted, or in the United States Court of Appeals for the District of Columbia Circuit. Such a review may be obtained by filing in any such court a written petition that such determination be modified or set aside. Such petition shall be filed—

"(A) only after such person has exhausted all administrative remedies under this chapter; and

"(B) within sixty days after the date on which the authority head sends such person a copy of the decision of such authority head under section 803(h)(2) of this title.

"(2) The clerk of the court shall transmit a copy of a petition filed under paragraph (1) of this subsection to the authority head and to the Attorney General. Upon receipt of the copy of such petition, the authority head shall transmit to the Attorney General the record in the proceeding resulting in the determination of liability under section 802 of this title. Except as otherwise provided in this section, the courts of appeals of the United States shall have jurisdiction to review the decision, findings, and determinations in issue and to affirm, modify, remand for further consideration, or set aside, in whole or in part, the decision, findings, and determinations of the hearing examiner, and to enforce such decision, findings, and determinations to the extent that such decision, findings, and determinations are affirmed or modified.

"(c) The findings of the hearing examiner with respect to questions of fact, if supported by substantial evidence on the record considered as a whole, shall be conclusive.

"(d) Any court of appeals reviewing under this section the decision, findings, and determinations of a hearing examiner shall not consider any objection that was not raised in the hearing conducted pursuant to section 803(e) of this title unless a demonstration is made of extraordinary circumstances causing the failure to raise the objection. If any party demonstrates to the satisfaction of the court that additional evidence not presented at such hearing is material and that there were reasonable grounds for the failure to present such evidence at such hearing, the court may remand the matter to the hearing examiner for consideration of such additional evidence.

"(e) Upon a final determination by the court of appeals that a person is liable under section 802 of this title, the court shall enter a final judgment for the appropriate amount in favor of the United States, and such judgment may be recorded and enforced by the Attorney General to the same extent and in the same manner as a judgment entered by any United States district court.

"§ 806. Collection of civil penalties and assessments

"(a) The Attorney General shall be responsible for judicial enforcement of any civil penalty or assessment imposed pursuant to the provisions of this chapter.

"(b) Any penalty or assessment imposed in a determination which has become final pursuant to section 803 of this title may be recovered in a civil action brought by the Attorney General. In any such action, no matter that was raised or that could have been raised in a hearing conducted under section 803(e) of this title or pursuant to judicial review under section 805 of this title may be raised as a defense, and the determination of liability and the determination of amounts of penalties and assessments shall not be subject to review.

"(c) The district courts of the United States and of any territory or possession of the United States shall have jurisdiction of any action commenced by the United States under subsection (b) of this section.

"(d) Any action under subsection (b) of this section may, without regard to venue requirements, be joined and consolidated with or asserted as a counterclaim, cross-claim, or setoff by the United States in any other civil action which includes as parties the United States and the person against whom such action may be brought.

"(e)(1) The United States Claims Court shall have jurisdiction of any action under subsection (b) of this section to recover any penalty and assessment of the cause of action is asserted by the United States as a counterclaim in a matter pending in such court. The United States may join as additional parties in such counterclaim all persons who may be jointly and severally liable with the person against whom such counterclaim is asserted.

"(2) No cross-claims or third-party claims not otherwise within the jurisdiction of the United States Claims Court shall be asserted among additional parties joined under paragraph (1) of this subsection.

"(f) The Attorney General shall have exclusive authority to compromise or settle any penalty and assessment the determination of which is the subject of a pending petition pursuant to section 805 of this title or a pending action to recover such penalty or assessment pursuant to this section.

"(g) Any amount of penalty and assessment collected under this chapter shall be deposited as miscellaneous receipts in the Treasury of the United States, except that such amounts collected by the United States Postal Service shall be deposited in the postal service fund established by section 2003 of Title 39, United States Code.

"§ 807. Limitations

"(a) No claim or statement alleged to be a false, fictitious, or fraudulent claim or statement shall be subject to liability under section 802 of this title at any time after six years after the date on which such claim or statement is made, presented, or submitted, or within three years from the date when facts material to the right of action are known or reasonably should have been known by the official within the authority charged with responsibility to act in the circumstances, whichever occurs last.

"(b) A civil action to recover a penalty and assessment under section 806 of this title shall be commenced within three years after the date on which the determination of liability for such penalty and assessment becomes final.

"(c) If at any time during the course of proceedings brought pursuant to this chapter the authority head receives or discovers any specific information regarding bribery, gratuities, conflict of interest, or other corruption or similar activity in relation to a false claim or statement, the authority head shall immediately report such information to the Attorney General, and in the case of an authority in which an

Office of Inspector General is established by the Inspector General Act of 1978 or by any other Federal law, to the Inspector General of that authority.

"§ 808. Regulations

"(a) Each authority head shall promulgate rules and regulations necessary to implement the provisions of this chapter.

"(b) The Attorney General may enter into a memorandum of understanding with the head of any authority to provide expeditious procedures for approving or disapproving the referral of allegations under section 803(b) of this title and for referral of matters for action under sections 805, 806, and 807(d) of this title. Such memorandum of understanding may provide advanced authorization to refer allegations under section 803(b) of this title with respect to any particular type or class of alleged false claims or statements if not otherwise barred by section 807 of this title.

"§ 809. Right to setoff

"(a)(1) The amount of any penalty and assessment which has become final under section 803(h)(1) of this title, or for which a judgment has been entered under section 805(e) or 806 of this title, or any amount agreed upon in a settlement or compromise under section 805(h)(2) of this title, may be deducted from any sum then or later owing by the United States to the person liable for such penalty and assessment, unless otherwise prohibited by law or except in those cases where the government has contractually agreed not to exercise its rights of setoff.

"(2) The authority head shall transmit written notice to the person liable for such penalty or assessment prior to commencing a deduction or series of deductions under this paragraph.

"(3) All amounts retained pursuant to this paragraph shall be remitted to the Secretary of the Treasury for deposits in accordance with section 806(g) of this title.

"(b) An authority head may forward a certified copy of any determination as to liability for any penalty and assessment which has become final under section 803(h)(1) of this title, or a certified copy of any judgment which has been entered under section 805(e) or 806 of this title to the Secretary of the Treasury for action in accordance with subsection (a) of this section.

(b) The table of chapters for part I of Title 5, United States Code, is amended by inserting after the item relating to chapter 7 the following new item:

"8. Administrative Penalties and Assessments for False Claims and Statements .... 801.".

SEC. 102. (a) Except as provided in subsection (b), this Act and the amendments made by this Act shall take effect 180 days after the date of enactment of this Act.

(b) Section 808(a) of title 5, United States Code (as added by section 101 of this Act) shall take effect on the date of enactment of this Act.

○

99TH CONGRESS
1ST SESSION

H. R. 3753

To amend title 31, United States Code, to increase the liability of any person who violates section 3729 of such title (relating to false claims) to 3 times, rather than 2 times, the amount of damages the United States Government sustains as a result of such violation.

IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 13, 1985

Mr. SHAW introduced the following bill; which was referred to the Committee on the Judiciary

---

A BILL

To amend title 31, United States Code, to increase the liability of any person who violates section 3729 of such title (relating to false claims) to 3 times, rather than 2 times, the amount of damages the United States Government sustains as a result of such violation.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subchapter III of chapter 37 of title 31, United States Code, is amended—

(1) in the first sentence of section 3729 by striking out "2 times" and inserting in lieu thereof "3 times"; and

(2) in subsection (a) of section 3730 by striking out "2 times" and inserting in lieu thereof "3 times".

(b) The amendments made by this Act shall apply with respect any civil actions brought under section 3730 after the date of the enactment of this Act for violations occurring before or after the date of the enactment of this Act.

○

Mr. **Glickman**. Now I call on our ranking member, Mr. Kindness.

Mr. **Kindness**. Thank you, Mr. Chairman. I welcome the opening of these hearings this morning.

As a member of the Committee on Government Operations as well as the Committee on the Judiciary, I have particular interest in improving the working relationship between Government contractors and the United States.

In the pursuit of the information that will hopefully be brought out in these hearings, I trust that our witnesses will understand if I approach the subject matter by dividing the consideration of contract law from tort law and criminal law.

There seems to be confusion existing in the various approaches before us with regard to these different areas of the law. I think it will be important for this subcommittee to assure that we are recommending legislation that will preserve the right of the public to get fair value for tax dollars spent in Government procurement. At the same time, the rights of individual contractors, Government employees involved in the procurement process, and any others that might be collaterally involved must be preserved and maintained and included in whatever system of recovery or penalty that might be involved.

I don't think we can make a silk purse out of a sow's ear by saying that penalties that are criminal in their basic nature are really civil penalties, particularly under the kind of proposals that are put forward in some of the measures that are before us.

Calling an action civil or administrative in nature doesn't make it that if, in fact, the effect of it is that of a criminal proceeding. After all, due process is rather basic to our constitutional system, I think, and worth considering in this process.

The other side of the picture is that we have problems that have been brought to the public's attention very noticeably and very forcefully over a period of years now, that indicate the way in which the United States of America procures products and services can do with some improvement.

It tends, from the standpoint of the Committee on Government Operations looking at such matters, that indicate that we have got to do more by way of internal improvement of our procurement process as well. All the blame for breakdowns in the contracting process cannot be placed purely on one side of the contracting process. We all realize that.

So I think there is another side of this that has to be considered and that is how we improve our procurement process from the Government side, a question which, admittedly, is within the jurisdiction of the Committee on Government Operations, not the Committee on the Judiciary.

Mr. Chairman, I want to express my appreciation for your prompt action in scheduling these hearings and with your intention of moving forward with legislation that will help to increase the competitive climate in Government contracting, and bring about the best usage of the American taxpayers' dollars in the procurement process.

Mr. **Glickman**. Thank you, Mr. Kindness.

Mr. Berman.

Mr. **Berman**. Thank you, Mr. Chairman.

I want to join my friend from Ohio in commending you for so quickly moving on this issue. The Senate, of course, starting much earlier, has moved the bill to the floor, sponsored by the chairman of the subcommittee, Senator Grassley, in this area. And with the array of activities in our subcommittee it would have been very easy to delay an area like this, and the fact that you didn't is greatly appreciated, I think by me personally and by, I think, the cause that this issue represents.

The chairman has spoken of the issue and of the existence of this law since the time of Abraham Lincoln. The basic principle, I think, is very clear. The United States, in many different areas of Government contracting, is being bilked and we need all the resources we can obtain to address the problem. For that reason, Berkley Bedell, Andy Ireland, and I introduced legislation, H.R. 3828, toward the end of last year, which strengthens the incentives for private citizens who have evidence of fraud against the United States to step forward and bring suit on behalf of the Government. That is precisely what H.R. 3828 does.

In my view, the qui tam provisions of H.R. 3828 are essential to making the False Claims Act a more effective tool against Federal contractor fraud. I am convinced that we must protect whistleblowers from being fired, harassed, suspended, or demoted. We must allow a plaintiff to maintain his or her involvement in a suit even if the U.S. attorney enters the case to insure that the case is effectively prosecuted on its merits. We must prevent suits from being dismissed simply by the Government's assertion that the Government already had the information brought forward by the plaintiff in order to ensure that the Government is indeed acting on that information. And we must provide guarantees of adequate monetary awards and attorneys' fees for plaintiffs in qui tam actions.

I hope that members of the subcommittee will be present tomorrow, and I would like to commend for their attention the testimony of a person from Los Angeles, John Phillips, who I have known a long time, who is director of the center for law in the public interest there, and is one of the witnesses scheduled to testify. His interest in this issue arose when his office began to receive contacts from would-be whistleblowers and his research into this area, which has been very extensive, has convinced him of the inadequacy of the present law.

Whether as a result of lack of resources, or worse, the Department of Justice has not done an acceptable job of prosecuting defense contractor fraud. In an era of Gramm-Rudman, as the chairman mentioned, and as we have moved toward a new-found reliance on private citizens to help right wrongs, the qui tam provisions of H.R. 3828 strike me as exactly what is needed to address the problem.

Some will choose to frame their opposition to these reforms in terms of unfounded fears that crackpots will take advantage of the qui tam provisions. The defense industry will certainly claim that H.R. 3828 provides draconian powers over small businessmen. Berkley Bedell and Andy Ireland are two prominent leaders in the Small Business Committee. They have listened to this allegation and it carries no water with them. I suggest that that is the correct conclusion.

In conclusion in my own opening remarks, it seems to me that only those who cheat the U.S. Government have anything to fear from the kind of provisions provided in H.R. 3828, and I urge my colleagues to weigh carefully the testimony we will hear on this issue and to consider the merits of that approach.

Finally, just let me thank you again, Mr. Chairman, for so quickly scheduling these hearings on this very important issue.

Mr. GLICKMAN. Thank you, Mr. Berman.

It is a pleasure to welcome the distinguished member of the full Judiciary Committee, Mr. Fish, who I know has been very active in this issue and has introduced major legislation in this issue. Mr. Fish, we welcome you to this subcommittee.

TESTIMONY OF HON. HAMILTON FISH, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK, ACCOMPANIED BY ALAN COFFEY, ASSOCIATE COUNSEL, JUDICIARY COMMITTEE

Mr. FISH. Thank you very much, Mr. Chairman, and members of the subcommittee. Accompanying me at the witness table is Alan Coffey, minority chief counsel to the Committee on the Judiciary.

I appreciate the opportunity to be with you and to testify regarding legislation which will greatly enhance the ability of the Federal Government to deal with fraud and waste in grant and loan programs and in procurement contracts.

I am the principal sponsor in the House of Representatives of the administration's proposals that are, in part, the focus of this hearing—the False Claims Act amendments, H.R. 3334, and the Program Fraud Civil Penalties Act, H.R. 3335.

As you stated in your opening remarks, Mr. Chairman, the False Claims Act is one of the oldest and potentially most effective remedies available to the United States to discourage and to respond to fraudulent misuse of Federal resources.

It is the principal statute upon which the Government relies to seek monetary recovery in fraud cases. Enacted in 1863, at the height of the Civil War, it permits the Federal Government to recover two times the amount of any false or fraudulent claim submitted, plus a $2,000 civil fine.

The amendments contained in my bills would make several statutory changes so as to resolve inconsistencies and ambiguities in the case law and to strengthen the Government's ability to investigate, litigate and otherwise resolve these fraud cases.

Before detailing the principal elements of these two bills, permit me to make some general observations. First, it needs to be stressed that we are dealing here with a civil, not a criminal, statute. The False Claims Act is remedial in nature. As it is now constituted, it does not contain any criminal sanctions and these legislative proposals do not themselves contain any criminal sanctions.

I emphasize this because in the past there has been considerable confusion prompted by judicial decisions that have treated the False Claims Act as if it were a criminal statute. These decisions have hampered the Federal Government in its efforts to effectively recover losses incurred as a result of fraud, waste, and abuse. These cases, in part, are the reasons why H.R. 3334 was introduced.

Second, while the False Claims Act is not a penal statute, it does have an important deterrent effect. The False Claims Act allows the Government, on behalf of the taxpayer, to recover losses suffered through the submission of fraudulent claims. The double damages remedy has been a part of the law since 1863 and it implicitly contains a significant deterrence element.

It is analogous to the treble damages remedy available to private plaintiffs under the antitrust laws and actions authorized under the civil RICO statute.

The double damages recovery, with the accompanying civil fine, is intended to be a substantial penalty—to forcefully discourage individuals and companies that do business with the United States from engaging in fraudulent practices.

It is my understanding that the subcommittee has before it other bills—H.R. 3753; H.R. 3828, by Mr. Berman and others—which propose that the current double damage remedy in the False Claims Act be amended to provide for treble damages, and as well to strengthen the citizens' suits provision.

I also understand that Senator Grassley's companion bill, S. 1562, on this subject also provides for treble damages. Frankly, having worked for many years with antitrust legislation, the idea of treble damages in this statute has both substantive and symmetrical appeal to me.

In this context, I might mention that very soon I will be introducing a five-part antitrust reform package on behalf of the administration. Included in that package will be an amendment to section 4A of the Clayton Act which would allow the United States as a plaintiff to recover treble damages under the antitrust laws.

Ironically, right now only private parties automatically have their damages trebled in antitrust actions, whereas the United States may only sue for either injunctive relief or, where it is the party actually harmed by the anticompetitive action, actual damages.

The United States will use these amendments to the Clayton Act to respond to circumstances where the Government is the victim of a price-fixing conspiracy or a contract bid-rigging situation. If the United States is prepared to amend the antitrust laws to allow treble damages in these circumstances, Mr. Chairman, it seems logical to me that this subcommittee consider treble damages in the context of the amendments to the False Claims Act as well.

Related to this debate is how this subcommittee ultimately decides the question of the appropriate definition of damages in the False Claims Act. My bill—H.R. 3334—would broaden the scope of the damages to be doubled. Under current law, the Federal Government is limited to actual damages, which are then doubled under the statutory formula. Sections 101(a) and 101(b) of H.R. 3334 would make consequential damages the measurement standard—thus allowing a recovery for indirect losses that are the result of the fraud as well as actual, direct losses. The Justice Department, for example, believes that this is a necessary change to ensure the recovery of replacement costs in every case.

There is a relationship between the decision on measurement of damages—actual versus consequential—and whether treble damages should replace double damages. I defer to the expertise of the members of this subcommittee as to whether or not the double damage remedy contained in the current law provides a sufficient deterrent.

My only point is that your resolution of the appropriate measurement of damages is an important and related element to consider as part of the overall policy decision.

I would add that the Department of Justice is understandably concerned that the insertion of a treble damage remedy could have the counterproductive result of encouraging courts to continue to view the False Claims Act as a criminal rather than a civil law.

Last, but not least, of my general observations, is a point that I feel must be stressed at the outset. I do not view these legislative proposals as anticontractor in nature. That is certainly not my motivation, nor do I believe it is the motive of the administration. Rather, these legislative proposals should be viewed as protaxpayer. There is no question in my mind but that the responsible representatives of the private sector share our common goals.

Specifically, these goals are an efficient Federal procurement process that results in the purchase of quality products and services at fair prices and that the Government should be able to effectively recover its losses when victimized by fraud.

Allow me now to turn to these proposed amendments contained in my two bills and highlight those that I think are the most deserving of note. To my mind, the most important amendments contained in H.R. 3334 deal wilth the intent standard and the burden of proof in the False Claims Act. The language of the act currently provides that the Federal Government need only prove that the defendant knowingly submitted a false claim.

However, this statutory standard has been misconstrued by some courts so as to require the Government prove the defendant had actual knowledge of the fraud and even establish specific intent to submit a false claim.

A specific intent standard, Mr. Chairman, is wholly inappropriate in a civil statute and section 101(c) of H.R. 3334 would remove the ambiguity created by this case law.

As with anyone who enters the marketplace, the Federal Government relies upon the truthfulness of the representations of those with whom it is doing business.

This amendment clarifies the confused case law to extend liability to those who seek payment from the Government misstating their eligibility or who certify information to the Government in support of a claim with neither personal knowledge as to its accuracy, nor reasonable investigative efforts to determine the truth.

This standard is not intended to cover innocent mistakes or inaccurate claims submitted through mere negligence. It is intended to require that those who do business with the Government recognize their obligation to take reasonable steps to ensure the accuracy of the claims they submit. Persons doing business with the United States should not be permitted to hide behind a convenient shield of self-imposed ignorance.

The burden of proof in civil false claims cases is another area where legislative clarification is necessary to resolve ambiguities in the case law. Some courts have required that the United States prove a violation by clear and convincing, even unequivocal, evidence. Here again, such a burden is the functional, near equivalent of a criminal standard. Because the False Claims Act is a civil statute, the traditional preponderance of the evidence burden of proof, in my judgment, is more appropriate. Consequently, section 103(c) of my bill specifically provides that the Government must prove its case by a preponderance of the evidence, the ordinary standard in civil litigation.

H.R. 3334 also contains numerous other amendments, which are designed to resolve specific problems which have arisen under the act. Mr. Chairman, they start at the bottom of page 6 of my prepared testimony and run through pages 7, 8, and 9. I will just highlight a couple of them and they will be made part of the record.

Section 101(a) raises the fixed statutory penalty for submitting a false claim from $2,000 to $5,000. And as you mentioned, the $2,000 figure has been in the law for over a century.

Section 101(a) also amends the act to permit the United States to bring an action against a member of the Armed Forces, something that was excluded from the act at the time of enactment in the Civil War era.

My bill also provides that an individual who makes a material misrepresentation to avoid paying money owed the Government would be equally liable under the act as if he had submitted a false claim for money or property. For instance, the manager of a HUD-owned property may falsely understate income and/or overstate expenses in order to reduce the rental receipts which must be paid to HUD at the end of each month. The existing failure to cover these so-called reverse false claims situations is a serious gap in the present law.

The requirement that there must be a strict demand for money or property before an actual claim can exist under the False Claims Act must be broadened. Instead, the concept of "claim" should cover all those circumstances where the Government suffers a financial loss through a fraudulent misrepresentation or statement.

Section 101(d) would allow the Federal Government to sue under the False Claims Act to prosecute frauds perpetrated on certain grantees, States, and other recipients of financial assistance.

Another important amendment contained in section 105 is the grant of civil investigative demand [CID] authority to the Department of Justice to aid in the investigation of False Claims Act cases. The CID provisions are patterned after and analogous to the authority already exercised by the Antitrust Division under Hart-Scott-Rodino.

If the Assistant Attorney General of the Civil Division believes that a person has access to information relating to a False Claims Act investigation, he may, prior to filing a complaint, require the production of documents, answers to interrogatories and oral testimony.

The standards governing subpoenas and ordinary civil discovery would apply so as to protect against disclosure of privileged information.

Allow me to briefly discuss the Program Fraud Civil Penalties legislation. H.R. 3335 is intended to provide Federal departments and agencies with an administrative option to litigation in smaller fraud cases—those under $100,000.

Frankly, the problem is that the Department of Justice currently does not have the resources to proceed with many of these small fraud cases and the crowded Federal Court dockets also makes these cases a very low priority.

The proposed Program Fraud Civil Penalties Act would establish, for the first time, a Governmentwide administrative mechanism to resolve small civil fraud cases outside the courts. These claims initially would be decided by hearing examiners. The inspectors general of the various departments and agencies would initiate such claims when the Department of Justice makes a determination that the Federal Government has a valid claim but that it has neither the time nor the resources itself to litigate. A finding of liability in the administrative proceeding could be appealed to a Federal circuit court.

I certainly agree with the statements made by Mr. Kindness and I want to emphasize that I strongly believe this legislation must afford the accused individual or company with full due process protections. Therefore, H.R. 3335 should be amended to make it clear that these proceedings will be on the record before a qualified administrative law judge.

Second, the legislation should make it abundantly clear that all the protections contained in the Administrative Procedures Act would be applicable in these hearings. This includes the right to adequate, fair notice, the right to be represented by counsel and the right to cross-examine.

Mr. Chairman, Senator Cohen's bill, S. 1134, makes it clear that these due process protections are available to the accused. That bill, as you know, has been favorably reported by the Senate Committee on Governmental Affairs.

I recognize that in the Senate there has been some controversy over the scope of the investigatory, testimonial subpoena power, and I again would defer to the expertise of this subcommittee to resolve that problem.

In conclusion, Mr. Chairman and members of the subcommittee, I want to commend you for holding these hearings so promptly. There is no question that Congress must seek out appropriate legislative mechanisms to insure that the taxpayers' money is well spent and protected from fraud, abuse, and waste.

Should this subcommittee proceed to mark up this legislation, it would seem logical to me to merge the two proposals contained in H.R. 3334 and H.R. 3335 into one omnibus bill. Such a clean bill should be structured as an amendment to title 31, with the necessary cross references to title 5. My staff and I, stand ready to work with the subcommittee on crafting legislation that we all can support.

I thank you again for this opportunity to testify.

[The statement of Mr. Fish follows:]

STATEMENT OF THE HONORABLE HAMILTON FISH, JR.

Thank you, Mr. Chairman and Members of the Subcommittee. I very much appreciate the opportunity to be here today and testify regarding legislation which will greatly enhance the ability of the Federal Government to deal with fraud and waste in grant and loan programs and procurement contracts.

I am the principal sponsor in the House of Representatives of the Administration's proposals that are, in part, the focus of this hearing this morning. These bills are the False Claims Act Amendments (H.R. 3334) and the Program Fraud Civil Penalties Act (H.R. 3335). I recognize that you have a number of witnesses scheduled this morning, so I will endeavor to keep my remarks brief.

The False Claims Act is one of the oldest and potentially most effective remedies available to the United States to discourage and respond to the fraudulent misuse of Federal resources. It is the principal statute upon which the government relies to seek monetary recovery in fraud cases. The statute was first enacted in 1863, at the height of the Civil War. It permits the Federal Government to recover two times the amount of any false or fraudulent claim submitted, plus a $2,000 civil fine. The amendments contained in my bills would make several statutory changes so as to resolve inconsistencies and ambiguities in the case law and to strengthen the government's ability to investigate, litigate and otherwise resolve fraud cases.

Before detailing the principal elements of these two bills, permit me to make some general observations. First, it needs to be stressed that we are dealing here with a civil -- not a criminal -- statute. The False Claims Act is remedial in nature. As it is now constituted, the False Claims Act does not contain any criminal sanctions and these legislative proposals do not contain any criminal provisions. The reason for my emphasis on this point is that considerable confusion has been prompted by judicial decisions that have treated the False Claims Act as if it were a criminal statute. These decisions have severely hampered the Federal Government in its efforts to effectively recover losses incurred as a result of fraud, waste and abuse. These cases, in part, are the reason why H.R. 3334 was introduced.

Secondly, while the False Claims Act is not a penal statute, it does have an important deterrent effect. The False Claims Act allows the government, on behalf of the taxpayer, to recover losses suffered through the submission of fraudulent claims. The double damages remedy has been a part of this law since 1863 and it implicitly contains a significant deterrence element. It is analogous to the treble damage remedy available to private plaintiffs under the antitrust laws and actions authorized under the civil RICO statute. The double damages recovery, with the accompanying civil fine, is intended to be a substantial penalty -- to forcefully discourage individuals and companies that do business with the United States from engaging in fraudulent practices.

It is my understanding that the Subcommittee has before it other bills (H.R. 3753; H.R. 3828) which propose that the current double damage recovery in the False Claims Act be amended to provide for treble damages. I also understand that Senator Grassley's companion bill (S. 1562) on this subject also provides for treble damages. Frankly, having worked for many years with antitrust legislation, the idea of treble damages in this statute has both some substantive and symmetrical appeal to me.

In this context, I might mention that very soon I will be introducing a four-part antitrust reform package on behalf of the Administration. Included in that proposal will be an amendment to Section 4A of the Clayton Act which would allow the United States as a plaintiff to recover treble damages under the antitrust laws. Ironically, right now only private parties automatically have their damages trebled in an antitrust action, whereas the United States may only sue for either injunctive relief or, where it is the party actually harmed by the anti-competitive action, actual damages. The United States will use these amendments to the Clayton Act to respond to circumstances where the government is the victim of a price-fixing conspiracy or a contract bid-rigging situation. If the United States is prepared to amend the antitrust laws to allow treble damages in these circumstances, it seems logical to me that this Subcommittee consider treble damages in the context of amendments to the False Claims Act as well.

Related to this debate is how this Subcommittee ultimately decides the question of the appropriate definition of damages in

THE FALSE CLAIMS ACT. MY BILL -- H.R. 3334 -- WOULD BROADEN THE SCOPE OF THE DAMAGES TO BE DOUBLED. UNDER CURRENT LAW THE FEDERAL GOVERNMENT IS LIMITED TO ACTUAL DAMAGES, WHICH ARE THEN DOUBLED UNDER THE STATUTORY FORMULA. SECTIONS 101(a) AND 101(b) OF H.R. 3334 WOULD MAKE "CONSEQUENTIAL DAMAGES" THE MEASUREMENT STANDARD -- THUS ALLOWING A RECOVERY FOR INDIRECT LOSSES THAT ARE THE RESULT OF THE FRAUD AS WELL AS ACTUAL, DIRECT LOSSES. THE JUSTICE DEPARTMENT, FOR EXAMPLE, BELIEVES THAT THIS IS A NECESSARY CHANGE TO ENSURE THE RECOVERY OF REPLACEMENT COSTS IN EVERY CASE.

THERE IS A RELATIONSHIP BETWEEN THE DECISION ON MEASUREMENT OF DAMAGES -- ACTUAL VERSUS CONSEQUENTIAL -- AND WHETHER TREBLE DAMAGES SHOULD REPLACE DOUBLE DAMAGES. I DEFER TO THE EXPERTISE OF THE MEMBERS OF THIS SUBCOMMITTEE AS TO WHETHER OR NOT THE DOUBLE DAMAGE REMEDY CONTAINED IN THE CURRENT LAW PROVIDES A SUFFICIENT DETERRENT. MY ONLY POINT IS THAT YOUR RESOLUTION OF THE APPROPRIATE MEASUREMENT OF DAMAGES IS AN IMPORTANT AND RELATED ELEMENT TO CONSIDER AS PART OF THIS OVERALL POLICY DECISION. I WOULD ADD THAT THE DEPARTMENT OF JUSTICE IS UNDERSTANDABLY CONCERNED THAT THE INSERTION OF A TREBLE DAMAGE REMEDY COULD HAVE THE COUNTERPRODUCTIVE RESULT OF ENCOURAGING COURTS TO CONTINUE TO VIEW THE FALSE CLAIMS ACT IN A CRIMINAL, RATHER THAN CIVIL, LIGHT.

LAST, BUT NOT LEAST, OF MY GENERAL OBSERVATIONS IS A POINT THAT I FEEL MUST BE STRESSED AT THE OUTSET. I DO NOT VIEW THESE LEGISLATIVE PROPOSALS AS ANTI-CONTRACTOR IN NATURE. THAT IS CERTAINLY NOT MY MOTIVATION, NOR DO I BELIEVE IT IS THE MOTIVE

OF THE ADMINISTRATION. RATHER, THESE LEGISLATIVE PROPOSALS SHOULD BE VIEWED AS PRO-TAXPAYER. THERE IS NO QUESTION IN MY MIND BUT THAT THE RESPONSIBLE REPRESENTATIVES OF THE PRIVATE SECTOR SHARE OUR COMMON GOALS. SPECIFICALLY, THOSE GOALS ARE AN EFFICIENT FEDERAL PROCUREMENT PROCESS THAT RESULTS IN THE PURCHASE OF QUALITY PRODUCTS AND SERVICES AT FAIR PRICES AND THAT THE GOVERNMENT SHOULD BE ABLE TO EFFECTIVELY RECOVER ITS LOSSES WHEN VICTIMIZED BY FRAUD.

ALLOW ME NOW TO TURN TO THOSE PROPOSED AMENDMENTS CONTAINED IN MY TWO BILLS AND HIGHLIGHT THOSE THAT ARE MOST DESERVING OF NOTE. TO MY MIND, THE MOST IMPORTANT AMENDMENTS CONTAINED IN H.R. 3334 DEAL WITH THE INTENT STANDARD AND THE BURDEN OF PROOF IN THE FALSE CLAIMS ACT. THE LANGUAGE OF THE FALSE CLAIMS ACT CURRENTLY PROVIDES THAT THE FEDERAL GOVERNMENT NEED ONLY PROVE THAT THE DEFENDANT "KNOWINGLY" SUBMITTED A FALSE CLAIM. HOWEVER, THIS STATUTORY STANDARD HAS BEEN MISCONSTRUED BY SOME COURTS SO AS TO REQUIRE THAT THE GOVERNMENT PROVE THE DEFENDANT HAD ACTUAL KNOWLEDGE OF THE FRAUD AND, EVEN, ESTABLISH SPECIFIC INTENT TO SUBMIT A FALSE CLAIM. SEE UNITED STATES V. MEAD, 426 F.2D 118 (9TH CIR., 1970). A SPECIFIC INTENT STANDARD, MR. CHAIRMAN, IS WHOLLY INAPPROPRIATE IN A CIVIL STATUTE AND SECTION 101(c) OF H.R. 3334 WOULD REMOVE THE AMBIGUITY CREATED BY THIS CASE LAW.

AS WITH ANYONE WHO ENTERS THE MARKETPLACE, THE FEDERAL GOVERNMENT RELIES UPON THE TRUTHFULNESS OF THE REPRESENTATIONS OF THOSE WITH WHOM IT DOES BUSINESS. THIS AMENDMENT CLARIFIES THE CONFUSED CASE LAW TO EXTEND LIABILITY TO THOSE WHO SEEK PAYMENT FROM THE GOVERNMENT MISSTATING THEIR ELIGIBILITY OR WHO CERTIFY

INFORMATION TO THE GOVERNMENT IN SUPPORT OF A CLAIM WITH NEITHER PERSONAL KNOWLEDGE AS TO ITS ACCURACY, NOR REASONABLE INVESTIGATIVE EFFORTS TO DETERMINE THE TRUTH. THIS STANDARD IS NOT INTENDED TO COVER INNOCENT MISTAKES OR INACCURATE CLAIMS SUBMITTED THROUGH MERE NEGLIGENCE. IT IS INTENDED TO REQUIRE THAT THOSE WHO DO BUSINESS WITH THE GOVERNMENT, RECOGNIZE THEIR OBLIGATION TO TAKE REASONABLE STEPS TO ENSURE THE ACCURACY OF THE CLAIMS THEY SUBMIT. PERSONS DOING BUSINESS WITH THE UNITED STATES SHOULD NOT BE PERMITTED TO HIDE BEHIND A CONVENIENT SHIELD OF SELF-IMPOSED IGNORANCE.

THE BURDEN OF PROOF IN CIVIL FALSE CLAIMS CASES IS ANOTHER AREA WHERE LEGISLATIVE CLARIFICATION IS NECESSARY TO RESOLVE AMBIGUITIES WHICH HAVE DEVELOPED IN THE CASE LAW. SOME COURTS HAVE REQUIRED THAT THE UNITED STATES PROVE A VIOLATION BY CLEAR AND CONVINCING, EVEN UNEQUIVOCAL, EVIDENCE. UNITED STATES v. UEBER, 299 F.2D 310 (6TH CIR., 1962). HERE, AGAIN, SUCH A BURDEN IS THE FUNCTIONAL, NEAR EQUIVALENT OF A CRIMINAL STANDARD. BECAUSE THE FALSE CLAIMS ACT IS A CIVIL STATUTE, THE TRADITIONAL "PREPONDERANCE OF THE EVIDENCE" BURDEN OF PROOF IS MORE APPROPRIATE. CONSEQUENTLY, SECTION 103(c) OF MY BILL SPECIFICALLY PROVIDES THAT THE GOVERNMENT MUST PROVE ITS CASE BY A PREPONDERANCE OF THE EVIDENCE, THE ORDINARY STANDARD IN CIVIL LITIGATION.

H.R. 3334 ALSO CONTAINS NUMEROUS OTHER AMENDMENTS, WHICH ARE DESIGNED TO RESOLVE SPECIFIC PROBLEMS WHICH HAVE ARISEN UNDER THE ACT:

- SECTION 101(a) RAISES THE FIXED STATUTORY PENALTY FOR

BEST COPY AVAILABLE

SUBMITTING A FALSE CLAIM FROM $2,000 TO $5,000. THE $2,000 FIGURE HAS REMAINED UNCHANGED SINCE THE INITIAL ENACTMENT OF THE FALSE CLAIMS ACT IN 1863.

- SECTION 101(a) ALSO AMENDS THE ACT TO PERMIT THE UNITED STATES TO BRING AN ACTION AGAINST A MEMBER OF THE ARMED FORCES, AS WELL AS AGAINST CIVILIAN EMPLOYEES. WHEN THE ACT WAS FIRST ENACTED IN 1863, THE MILITARY WAS EXCLUDED BECAUSE THE GOVERNMENT HAD AVAILABLE MORE SEVERE MILITARY REMEDIES.
- ALSO, AS I MENTIONED EARLIER, H.R. 3334 WOULD PERMIT THE GOVERNMENT TO RECOVER ANY CONSEQUENTIAL DAMAGES IT SUFFERS FROM THE SUBMISSION OF A FALSE CLAIM.
- MY BILL ALSO PROVIDES THAT AN INDIVIDUAL WHO MAKES A MATERIAL MISREPRESENTATION TO AVOID PAYING MONEY OWED THE GOVERNMENT WOULD BE EQUALLY LIABLE UNDER THE ACT AS IF HE HAD SUBMITTED A FALSE CLAIM FOR MONEY OR PROPERTY. FOR INSTANCE, THE MANAGER OF HUD-OWNED PROPERTY MAY FALSELY UNDERSTATE INCOME AND/OR OVERSTATE EXPENSES IN ORDER TO REDUCE THE RENTAL RECEIPTS WHICH MUST BE PAID TO HUD AT THE END OF EACH MONTH. THE EXISTING FAILURE TO COVER THESE SO-CALLED "REVERSE FALSE CLAIMS" SITUATIONS, IS A SERIOUS LOOPHOLE IN THE PRESENT LAW. THE REQUIREMENT THAT THERE MUST BE A STRICT DEMAND FOR MONEY OR PROPERTY BEFORE AN ACTUAL "CLAIM" CAN EXIST UNDER THE FALSE CLAIMS ACT MUST BE BROADENED. INSTEAD, THE CONCEPT OF "CLAIM" SHOULD COVER ALL THOSE CIRCUMSTANCES WHERE THE GOVERNMENT SUFFERS A FINANCIAL LOSS, THROUGH A FRAUDULENT MISREPRESENTATION OR STATEMENT.

- Section 101(d) would allow the Federal Government to sue under the False Claims Act to prosecute frauds perpetrated on certain grantees, states and other recipients of financial assistance. A recent decision, United States v. Azzarelli Construction Co., 647 F.2d 757 (7th Cir., 1981), has created some confusion with respect to whether the Federal Government may recover in grant cases where the Federal contribution is a fixed sum.
- Section 101(e) creates a new, uniform remedy to permit the government to seek preliminary injunctive relief to prevent a defendant from transferring or dissipating assets pending the completion of False Claims Act litigation.
- Section 104 modernizes the jurisdiction and venue provisions of the False Claims Act to permit the government to bring suit not only in the district where the defendant is "found" (the current standard), but also where a violation "occurred". Currently, when multiple defendants live in different districts, the government may be required to bring multiple suits, a time-consuming process that is wasteful of judicial resources.
- Section 103 of H.R. 3334 also modifies the statute of limitations to permit the government to bring an action within six years of when the false claim is submitted (the current standard) or within three years after the government learns of the violation, whichever date is later.
- Another important amendment -- contained in Section 105 -- is the grant of Civil Investigative Demand (CID) authority

to the Department of Justice to aid in the investigation of False Claims Act cases. The CID provisions are patterned after and analogous to the authority already exercised by the Antitrust Division under the Hart-Scott-Rodino Act. 15 U.S.C. 1311-1314. If the Assistant Attorney General of the Civil Division believes that a person has access to information relating to a False Claims Act investigation, he may, prior to filing a complaint, require the production of documents, answers to interrogatories and oral testimony. The standards governing subpoenas and ordinary civil discovery would apply so as to protect against the disclosure of privileged information. The CID could be enforced in district court, like any other subpoena. The use of CID authority in the antitrust context has been upheld as constitutional. Hyster Company v. United States, 338 F.2d 183 (9th Cir., 1964); Petition of Gold Bond Stamp Company, 221 F. Supp. 391 (D. Minn. 1963), aff'd., 325 F.2d 1018 (8th Cir., 1964).

Allow me now to briefly discuss the Program Fraud Civil Penalties legislation. H.R. 3335 is intended to provide Federal departments and agencies with an administrative option to litigation in smaller fraud cases -- those under $100,000. Frankly, the problem is that the Department of Justice currently does not have the resources to proceed with many of these small fraud cases and the crowded Federal court dockets also make such cases a low priority.

The proposed Program Fraud Civil Penalties Act would establish, for the first time, a government-wide administrative mechanism to resolve small civil fraud cases, outside the courts. These claims initially would be decided by hearing examiners. The Inspectors General of the various departments and agencies would initiate such claims when the Department of Justice makes a determination that the Federal Government has a valid claim but that it has neither the time nor the available resources to litigate. Any finding of liability in the administrative proceeding could be appealed to a Federal circuit court.

I want to emphasize that I strongly believe that this legislation must afford the accused individual or company with full due process protections. Therefore, H.R. 3335 should be amended to make it clear that these proceedings will be "on the record" before a qualified administrative law judge. Secondly, the legislation should make it abundantly clear that all the protections contained in the Administrative Procedure Act would be applicable in these hearings. This includes the right to adequate, fair notice, the right to be represented by counsel and the right to cross-examine. Senator Cohen's bill -- S. 1134 -- makes it clear that these due process protections are available to accused persons. (That bill has been favorably reported by the Senate Committee on Governmental Affairs.) I recognize that in the Senate there has been some controversy over the scope of the investigatory, testimonial subpoena power, and I again would defer to the expertise of this Subcommittee to resolve that particular problem.

In conclusion, Mr. Chairman and Members of this Subcommittee, I want to commend you for holding these hearings so promptly. There is no question that Congress must seek out appropriate legislative mechanisms to insure that the taxpayers' money is well spent and protected from fraud and waste. Should this Subcommittee proceed to mark up this legislation, it would seem logical to me to merge the two proposals contained in H.R. 3334 and H.R. 3335 into one omnibus bill. Such a clean bill should be structured as an amendment to title 31, with the necessary cross references to title 5. My staff and I stand ready to work with the Subcommittee on crafting legislation that we all can support.

Thank you, again, for this opportunity to testify.

Mr. **Glickman**. Thank you, Ham, I appreciate your statement. I think that you touch on all the issues very intelligently and very thoroughly.

Just for your information, I intend to introduce a bill which does do basically what you suggest at the end, which combines a variety of sections into one piece of legislation. Then what we will do is we will have several bills to look at as we go forward and make a decision into the markup process.

I do think that most of the ideas that are embodied in your suggestions are in the bill that I am considering and we will address these aspects in the in the course of our markup as all of these things kind of relate. I know that there's other legislation—as Mr. Berman indicated, he has some legislation as well. But I think generally we are on the same track on this thing. I don't think anybody is too far off that track.

We appreciate very much your testifying today and we will work together with you.

Mr. **Fish**. Thank you, Mr. Chairman.

Mr. **Glickman**. Mr. Kindness.

Mr. **Kindness**. Thank you, Mr. Chairman.

Thank you, Mr. Fish, I appreciate the good presentation.

I would like to ask a couple of questions just for clarification of intent. With respect to the Program Fraud Civil Penalties Act, is it intended that that would include tax returns and tax cases, and would they be subject to the administrative procedure that would be provided by this legislation? And, if so, is it intended to change the statute of limitations from 5 to 6 years?

Mr. **Fish**. Mr. Kindness, as I said, this is the first time a Governmentwide administrative mechanism has been proposed to deal with small fraud cases. I am told that it is based on a successful similar mechanism adopted by HHS a few years ago as a cost-savings method. There is no exclusion for tax cases in the legislation.

Mr. **Kindness**. I guess what I am getting at, would it be wise to do that since there is a set of procedures?

Mr. **Fish**. Yes; I think this is something that should be decided by the subcommittee. There is some problem with the application of the Administrative Procedure Act with respect to tax cases. And, as you say, there already is a mechanism of this kind in place.

Mr. **Kindness**. Another question concerning the program fraud aspect——

Mr. **Fish**. I beg your pardon?

Mr. **Kindness**. Another question concerning the program fraud aspect would be its application to such things as small business loans and whether it would be the intent of the author to have this approach apply in all cases such as that, as well as perhaps welfare cases, food stamps, and the like, where some provisions already exist in the law? That is, is it the intent of the author to preempt existing approaches?

Mr. **Fish**. The recovery may be different if it is not concluded under this. I don't see where the legislation would not cover the situations that you mentioned. I would think they would be correct.

Mr. **Kindness**. I am thinking of your recommendation with respect to the policy involved, and whether you feel that is a desirable approach to have it be applicable across the board with selected exceptions, perhaps such as tax cases.

Mr. FISH. Despite the fact that you have a Governmentwide program, you are going to have the hearings conducted by the respective agencies and departments. The example you gave me of the Small Business Administration, with their expertise and knowledge of the conduct of their programs—they would be the ones conducting investigations; they would be the ones bringing the matter to the attention of the Justice Department; and they would be the ones deciding whether to pursue it.

Mr. KINDNESS. I am thinking, for example, and you and your staff may have had such experiences, where we have attempted to assist people applying for small business loans—and particularly for the startup of a business—where they really don't have information all that accurate available to provide in an application, and some of it is, let's say, quite estimated, or terribly estimated. I have a little discomfort in applying this concept to cases of that nature.

Mr. FISH. I can understand that, Mr. Kindness. I think what we are talking about here is trying to reach intentional fraud and gross negligence.

I am sure we could all point to cases of which we have knowledge in where fairly innocent actions were involved.

Mr. KINDNESS. Just one more question if I might. As a matter of policy, in view of the type of action that is proposed here in the administrative remedy area, should administrative law judges who deal with these cases then be made much more independent than they are of the agencies with which they are associated today, and should they perhaps be made article 3 judges?

Mr. FISH. I noted that in my testimony, you recall, by referring to qualified administrative law judges. I understand that there are bills before your subcommittee that respond to this issue. In other cases we have tried to give a certain degree of independence, even within a department, to the judges, and I think this would enhance the credibility of administrative law judges.

Mr. KINDNESS. But basically, administrative law judges would be adequate, in your view, for the handling of these cases?

Mr. FISH. I think so. We are not talking about a judgment that is final. We are talking about lesser amounts of money recovery and by judges who will not make the final decision.

Mr. KINDNESS. One supplementary question, then. I believe the proposal is that the appeal from these administrative law judges' decisions would be to the court of appeals?

Mr. FISH. That is correct.

Mr. KINDNESS. And not to the district court where the standard of review would be that of an administrative proceeding. And if the individual who was affected took an appeal, there would, of course, not be any hearing de novo.

Are you comfortable with that concept in applying the penalties or the extra damages?

Mr. FISH. Could I at this time, Mr. Chairman—I have neglected to say—and ask at this point at the beginning of my remarks, that I identify Mr. Alan Coffey, chief minority counsel of the House Committee on the Judiciary as being present at the witness table with me. With your permission, I will ask him if he would comment on this.

Mr. GLICKMAN. Of course. Mr. Coffey.

Mr. COFFEY. Mr. Kindness, two things. Under the program fraud civil penalties proposals, the administrative law judge, as I understand it, or the hearing examiner, under the language of the bill, would make a recommended decision and the agency would make the final decision, as is the case under the Administrative Procedure Act.

So, the appeal would really be on the final agency decision made by the Secretary or the Commissioner, or whatever.

Second, the standard of judicial review—Mr. Fish mentioned in his prepared testimony that the APA standards ought to apply across the board. There should be an amendment to the bill to make it clear that we are talking about the substantial evidence rule—arbitrary, capricious, and not supported by substantial evidence, that is the normal standard of judicial review in the courts for this kind of a case.

Mr. KINDNESS. Thank you.

Thank you, Mr. Chairman.

Mr. GLICKMAN. Thank you.

Mr. Berman, Mr. Staggers have any questions of Mr. Fish?

Mr. BERMAN. Just one.

Mr. GLICKMAN. Yes. Mr. Berman.

Mr. BERMAN. Thank you, Mr. Chairman.

Mr. Fish, this is more in the way of a comment than a question. The bills you have been discussing are bills you have introduced on behalf of the Justice Department, I take it?

Mr. FISH. That is correct.

Mr. BERMAN. And as such, they reflect no changes in the qui tam provisions of the existing law?

Mr. FISH. That is correct.

Mr. BERMAN. I just hope as the process moves on, that we could be part of persuading you that some changes are warranted to make those more effective—and simply to point out that over on the Senate side a compromise has been struck, which I understand doesn't bow into the administration in their efforts here, but has been struck which accept some significant changes in that legislation in the bill that was reported out of the Senate Judiciary Committee.

Mr. FISH. I understand the gentleman's interest in this. And because it wasn't part of the recommended changes by the Department of Justice, I didn't go into it at any length, but I am aware that there is considerable sentiment for changing that as well as the civil fine.

Mr. BERMAN. Thank you.

Mr. FISH. Thank you.

Mr. GLICKMAN. Mr. Staggers.

Mr. STAGGERS. Mr. Fish, I want to compliment you for your interest and hard work in this varioum. And also, it has been a joy working with you on the full committee. I do have a couple questions.

Along the lines of what Mr. Kindness was getting into with the program and how broad is going to be the coverage, also with the knowingly—you mentioned that section 101(c) would remove the ambiguity created by the case law.

Can you explain how you do that? Are you just removing?

Mr. **Fish**. We remove the intent, Mr. Staggers. This is found on page 3 of H.R. 3334, line 12, which states: "No proof of intent to defraud or proof of any other element of a claim for fraud at common law is required."

Mr. **Staggers**. So, there is intent. And then later in your testimony you talked about that any claim should cover all circumstances where the Government suffers financial loss. I think that appears fairly broad.

Mr. **Fish**. Yes; are you referring to the reverse false claim?

Mr. **Staggers**. Am I mixing apples and peaches?

Mr. **Fish**. Tell me what page of my testimony you are on.

Mr. **Staggers**. Page 7.

Mr. **Fish**. Yes; that is the reverse false claim. That is where a material misrepresentation is made to avoid paying money owed the Government.

Mr. **Staggers**. So, that's two different——

Mr. **Fish**. It is the other side of the coin to making a false claim for the receipt of payment by the Government.

Mr. **Staggers**. One other question. On page 7 you talk about the $2,000 raising it to $5,000.

Mr. **Fish**. Yes.

Mr. **Staggers**. And the chairman's opening comments, he talked about the value of the $2,000 would be substantially more than $5,000. Is that—someone said $17,000.

Mr. **Fish**. Let me leave that to the Department of Justice witness, may I, because they are aware of the fact that there is sentiment for $10,000—as the chairman said, $17,000 would be a purchase power equal.

Mr. **Staggers**. So, that is not something you are locked into?

Mr. **Fish**. No; I am not locked into this at all. This is another matter for the determination by the subcommittee.

Mr. **Staggers**. Thank you.

Thank you, Mr. Chairman.

Mr. **Glickman**. Thank you, Mr. Fish, appreciated your testimony.

Mr. **Fish**. Thank you.

Mr. **Glickman**. Our next two House Members are not here so we will now go to the Department of Justice testimony, Mr. Richard Willard, Assistant Attorney General.

Mr. Willard, you are becoming a regular before this subcommittee.

TESTIMONY OF RICHARD K. WILLARD, ASSISTANT ATTORNEY GENERAL, CIVIL DIVISION, DEPARTMENT OF JUSTICE

Mr. **Willard**. Thank you, Mr. Chairman.

I would like to express the appreciation of the administration and the Department for Mr. Fish's introduction of our two bills, and for his testimony this morning. We really appreciate his effort and concern in this area, and his courtesy to the Department in introducing these bills.

Mr. **Glickman**. Mr. Willard, before you begin, first of all, your entire statement will appear in the record, and we appreciate your testifying.

My staff tells me we have had some difficulty getting your statements to us in a timely fashion. I would just mention that for the record because it helps us when we have it a little bit in advance so we can review it.

Mr. **Willard**. I understand, Mr. Chairman and I would like to apologize for that. Part of the problem is the folks at OMB are pretty jammed up this week with budgets and everything else, and we didn't get OMB clearance until yesterday afternoon.

Mr. **Glickman**. OK.

Mr. **Willard**. We have tried to and hope to continue to work closely with your staff to keep them informed as to what we are up to, and to answer questions. Again, I apologize, though, for the tardiness of getting the statement up.

Mr. **Glickman**. Very good. Why don't you proceed?

Mr. **Willard**. Mr. Chairman, I would propose just to summarize my statement since it is being included in the record. I would like to express my appreciation to you and this subcommittee for scheduling prompt hearings on the administration's antifraud legislation. We are looking forward to seeing your bill, Mr. Chairman.

We appreciate your comments about how we all seem to be moving along and very closely on track in addressing these problems.

As the Civil Division's oversight subcommittee, I always appreciate the chance to appear here. I am looking forward to coming back shortly for our authorization hearing and discussing more generally what we do.

But one of the most important things we do in the Civil Division is our civil fraud work. Over the last couple of years, we have expanded considerably the number of lawyers we have in this area. We currently have 853 pending matters involving fraud against the Government, and we are pursuing these potential and active cases vigorously. This is one of our highest priorities.

We are proud of the record that we have compiled, but we do think that legislation would allow us to pursue these cases more effectively.

Basically, the False Claims Act amendments, contained in administration's bill, H.R. 3334, provide a series of modifications and updates to this statute. As you observed, Mr. Chairman, this is an old statute. It was last amended in 1943, so we think it may be about time for a 43-year checkup on this act to make some changes. That is basically what we have done. None of our amendments would revolutionize the act. We believe basically the False Claims Act is a solid statute that has been effective.

But as with any other law, which has been in effect for a long period of time, certain changes can make it work better. Therefore, we have prepared amendments to eliminate some of what we think are erroneous judicial interpretations that have crept in the case law over the last 43 years.

Perhaps the two most significant amendments, which have already been discussed today to some extent, are a change in the standard of knowledge required for a violation and a clarification of the burden of proof.

The standard of knowledge has been, we think, misconstrued by some courts to require actual knowledge or specific intent to defraud the Government. We believe this is more appropriate for a criminal rather than a civil remedy and, therefore, propose to change that standard.

Now, since the submission of our bill, this standard has been the subject of extensive discussion with the Senate Judiciary and Governmental Affairs Committees. In an effort to clarify this important definition, the two committees, in consultation with the Justice Department and members of the private bar, have adopted a modified formulation which we do recommend. This is discussed in my prepared statement, on pages 7 and 8.

The revised standard that we propose would cover the situation where a defendant "knows or has reason to know" a claim is false, this state of mind is defined as having actual knowledge that the claim is false—and I am quoting now—"if he acts in gross negligence of the duty to make such inquiry as would be reasonable and prudent to conduct under the circumstances to ascertain the true and accurate basis of the claim of statement."

The standard really achieves two goals. One is to make it clear that something more than mere negligence is necessary for the Government to have a cause of action under this statute. No one desires to use this act against someone who makes an inadvertent or innocent mistake in submitting a claim.

On the other hand, the standard is also designed to make it clear that people who submit claims to the Government have some burden to take reasonable steps to assure themselves that those claims are accurate, and that they cannot adopt a see no evil, hear no evil, speak no evil sort of attitude about claims they are submitting for Government money.

We think that this standard is a reasonable one, and it is explained in more detail in a Justice Department letter to Senator Mathias, dated December 11, 1985, which is attached to my prepared statement.

Second, we think some courts have gone off the path by requiring the Government to carry a very heavy burden of proof in many cases—clear, unequivocal, convincing evidence—the kind of standard that is appropriate for criminal, but we do not think for civil liability. Therefore, we propose to return to the traditional preponderance of the evidence standard.

Finally, the bill contains numerous other amendments which were designed to resolve specific problems that have come up in our enforcement of this act, particularly ones created by various judicial decisions.

One change, which we have already discussed, is raising the statutory penalty from $2,000 to $5,000.

Second, our bill amends the act to permit the United States to bring an action against a member of the Armed Forces as well as civilian employees.

Third, it contains an amendment to allow us to use the act to recover consequential damages as well as direct damages.

Fourth, the proposal provides that where an individual makes a material misrepresentation to avoid paying money, the Government would be able to seek redress under the act—what Mr. Fish referred to as the "reverse false claim" situation.

Fifth, the bill would allow the Federal Government to sue under the False Claims Act to prosecute frauds perpetrated on certain grantees, States, and other recipients of Federal assistance.

Sixth, the bill creates a new uniform remedy to permit the Government to seek preliminary injunctive relief to bar defendants from dissipating or transferring their assets prior to judgment.

Seventh, the bill modernizes the jurisdiction and venue provisions of the False Claims Act.

Eighth, the bill modifies the statute of limitations to include a discovery rule, to address situations where the Government does not learn about the falsity of the claim at the time it was submitted.

Finally, the bill provides that a nolo contendere plea in a criminal prosecution, like a guilty plea, would stop a defendant from denying liability in a civil suit involving the same transaction.

Finally, the last important amendment included in the bill is the grant of a civil investigative demand or a CID authority to the Civil Division for aid in investigating these cases. Our proposal is modeled on the authority which was granted to the Antitrust Division in the Hart-Scott-Rodino Act of 1976.

The only substantive difference is that our bill would allow the Civil Division to share information it obtains through CID's with other Federal agencies for use in furtherance of their statutory responsibilities, which could include enforcement of environmental and safety laws, banking regulatory laws and suspension and debarment actions.

The next point I would like to address is the citizen suit, or qui tam, provisions, which some have proposed to amend.

The administration bill does not change the existing law. While we believe that on occasion this provision has produced information that would otherwise not be available to the Government, we are concerned that the proposed changes would create additional problems. For example, one proposal would allow the party who makes the claim to continue to participate in litigation even if the case is taken over and is being litigated by the Justice Department. This would create the problem of two parties separately trying to conduct the same litigation.

It raises the possibility of collusive litigation as well as simply a diminution of the effectiveness of pursuing the claim.

In addition, there is the problem of the parasitic lawsuit in which bounty hunters filed suits based on information already known to the Government in order to obtain money. This, in fact, was one reason for the 1943 amendments by Congress to the False Claims Act.

Finally, there are several legitimate reasons why the Department may choose not to bring a civil action on the basis of information it may have. There may be an ongoing criminal case or investigation that would be jeopardized by a civil suit. Or, again by holding off and conducting a more detailed investigation, the Government may be able to make a better case or bring in other defendants.

Finally, the allegations may involve conduct which is not improper, and which the Department, in the exercise of its prosecutorial discretion, does not believe should be pursued.

These proposed amendments are particularly troublesome because in recent years we have seen a growing number of frivolous qui tam actions brought against public figures for political motives. Members of Congress, executive branch officials, and even the President have been sued on the basis of information which raised questions about the expenditure of Federal money.

In conclusion, the Department has strong reservations about any change in the qui tam provisions of the act. Following lengthy discussions with members of the Senate Judiciary Committee, the qui tam provisions in S. 1562 were modified in a way that permitted the Justice Department to support Judiciary Committee passage of S. 1562. However, we still object to any change in the current statute.

Finally, I would like to turn very briefly to the Program Fraud Civil Penalties Act which would establish an administrative forum to prosecute the submission of false claims and statements of the United States. I believe Mr. Fish's statement and testimony described as well as I could the reasons why this kind of administrative remedy is important. I would like to point out that one of our later witnesses today—Inspector General Kusserow—will be able to explain how the Department of HHS has used similar authority granted to it under the Civil Money Penalty Law to collect over $18 million in fraudulent overcharges under Medicare and Medicaid.

I think the Inspector General and his entire department should be commended for their efforts in this area. We propose to extend the successful HHS Program Governmentwide.

In conclusion, Mr. Chairman, I would like to again state my appreciation to the subcommittee for holding these hearings and giving very serious consideration to the problem of fraud against the Government.

Thank you, Mr. Chairman. I am now prepared to answer any questions you or the other members of the subcommittee may have.

[The statement of Mr. Willard follows:]

STATEMENT OF RICHARD K. WILLARD, ASSISTANT ATTORNEY GENERAL, CIVIL DIVISION

Mr. Chairman and Members of the Subcommittee --

It is a pleasure to appear before the Subcommittee this morning to discuss the critical issue of improving our civil anti-fraud remedies. The legislation being considered today -- a part of the President's Management Improvement Program -- symbolizes the significant priority which the Administration places on an aggressive effort against economic crime. In conjunction with the increased investigative and prosecutorial resources which we have devoted to fraud cases, this legislation will greatly enhance our anti-fraud efforts. We strongly welcome the support of Members of Congress in this effort.

Since their announcement as part of our eight-bill package by the Attorney General last September, the two Administration bills which are before the Subcommittee today have received strong and bipartisan support. Senator Cohen's Program Fraud Civil Remedies Act, S. 1134, which is similar to the Administration's administrative remedies bill, was reported out of the Governmental Affairs Committee unanimously and may be considered by the full Senate shortly. Our False Claims Act Amendments have been incorporated, with some changes, in Senator Grassley's bill, S. 1562, which was ordered reported by the Senate Judiciary Committee last December. There, too, we hope for prompt Senate action.

I.

Before turning to H.R. 3334, H.R. 3335 and other bills, Mr. Chairman, I would like to place this legislation into context by reviewing the Justice Department's role in the investigation and prosecution of false and fraudulent claims. The need for this legislation becomes apparent when seen in relation to the Justice Department's large and growing responsibilities for the prosecution of complex, economic fraud cases. It is particularly critical that we be able to delegate the smaller civil fraud cases to departments and agencies if we are to meet our other obligations.

As I noted, over the last few years we have devoted additional resources to the civil fraud enforcement effort, and, as a consequence, have developed better and more significant cases. We have 853 cases currently pending in the Civil Division and our recoveries average in the neighborhood of $1 million for each case which we deem to warrant civil action. Additional hundreds of False Claims Act cases are delegated to the United States Attorneys' offices each year.

As you know, Mr. Chairman, the United States has both civil and criminal remedies which it may pursue in prosecuting fraud. While we should never neglect the potential for criminal sanctions, especially in particularly egregious cases, civil sanctions can be equally powerful. As a general rule, our civil fraud prosecution effort is only as good as the criminal and administrative investigations on which nearly all civil fraud cases are based. FBI reports are one major source of leads. However, in recent years, the Inspectors General have provided a growing share of our civil fraud referrals.

The various civil remedies available to us provide a substantial deterrent to the submission of false and fraudulent claims. Because of the double-damages remedy in the False Claims Act, the government can often recover substantial sums in such prosecutions. Finally, because it requires a lower burden of proof, a civil action may be a more realistic course in close cases.

A diligent and tenacious anti-fraud effort serves to reinforce public confidence in the integrity and efficiency of government programs. At a recent speech in Boston, the Attorney General reiterated the need to aggressively prosecute economic crime. He noted that fraud committed against the United States, particularly fraud in defense procurement, has and will continue to receive high priority by the Department.

We are proud of our record in the area of economic crime and are confident that the record will show more major economic crime prosecutions in recent months than for any comparable period in the last decade. The Department of Justice has an unrelenting commitment to pursuing white-collar crime, and we believe an objective and informed review of the record will demonstrate that the dedicated and able prosecutors and investigators responsible for the large number of important and innovative prosecutions of recent months deserve accolades for their determination and imagination in attacking the frequently very complex patterns of such criminal conduct. The tools we have proposed in our Anti-Fraud Enforcement Initiative will provide genuine assistance in our common efforts to root out and punish fraudulent conduct.

II

Let me turn now to a discussion of the Administration's False Claims Act Amendments, H.R. 3334 and, where appropriate, to compare it with the other bills before the subcommittee. The False Claims Act currently permits the United States to recover double damages plus $2000 for each false or fraudulent claim. Enacted in 1863 in response to cases of contractor fraud perpetrated on the Union Army during the Civil War, this statute has been indispensible in defending the federal treasury against unscrupulous contractors and grantees. Although the government may also pursue common-law contract remedies, the False Claims Act is a much more powerful tool in deterring and punishing fraud.

A.

Since the Act was last amended in 1943, we have identified several areas where improvements are warranted, or where we believe judicial interpretations have been incorrect. Perhaps the most significant amendments contained in H.R. 3334 are two which go to the heart of the civil enforcement provisions of the Act: the standard of knowledge required for a violation and the burden of proof. As a civil remedy designed to make the government whole for losses it has suffered, the law currently provides that the government need only prove that the defendant knowingly submitted a false claim. However, this standard has been misconstrued by some courts to require that the government prove that the defendant had actual knowledge of the fraud, and even to establish that the defendant had specific intent to submit the false claim. Eg., United States v. Mead, 326 F.2d 118 (9th Cir. 1970). This standard is inappropriate in a civil remedy, and H.R. 3334 would clarify the law to remove this ambiguity.

The bill would also establish a standard of scienter, or intent, which punishes defendants who knowingly submit false claims. The key term "knowingly" is defined to punish a defendant who:

> (1) had actual knowledge; or
> (2) had constructive knowledge in that the defendant had reason to know that the claim or statement was false or fictitious;

This standard was crafted to permit the government to recover for frauds where the responsible officers of a corporation deliberately attempt to insulate themselves from knowledge of false claims being submitted by lower-level subordinates. This ostrich-like conduct may occur in large corporations, and the United States can face insurmountable difficulties in attempting to establish that responsible corporate officers had actual knowledge of the fraud. This standard would not punish mistakes or incorrect claims submitted through mere negligence, but it does recognize that those doing business with the government have an obligation to ensure that the claims which they submit are accurate.

We believe that this standard reflects well-developed scienter concepts which would fully protect honest contractors. The False Claims Act has been in place since 1863, and we are unaware of any case under the Act in which a contractor has been punished for an honest dispute with the government. In particular, we would strongly oppose any effort to engraft upon the existing scienter standard another requirement that a knowingly false claim must be accompanied by an intent to defraud. In our experience, intent requirements in the civil area lead to confusion and impose an overly-stringent burden upon the government. The False Claims Act is not generally interpreted to require a showing of intent, see, e.g., United States v. Cooperative Grain & Supply Co., 476 F.2d 47 (8th Cir. 1973), and we do not believe that such an intent requirement should be imposed here.

Since the submission of our bill, the standard of constructive knowledge has been the subject of extensive discussion and negotiation by the Senate Judiciary and Governmental Affairs Committees. In an effort to clarify this important definition, the two committees, in consultation with the Justice Department and members of the private bar, have adopted a modified formulation which we recommend to this House. This revised standard provides that a defendant "knows or has reason to know" that a claim is false if he had actual knowledge that a claim is false or if he:

> ...acts in gross negligence of the duty to make such inquiry as would be reasonable and prudent to conduct under the circumstances to ascertain the true and accurate basis of the claim or statement.

This standard achieves two goals. First, it makes clear that something more than mere negligence is required for a finding of liability. Second, it reaffirms the widely shared belief that anyone submitting a claim to the government has a duty -- which will vary depending on the nature of the claim and the sophistication of the applicant -- to make such reasonable and prudent inquiry as is necessary to be reasonably certain that he is, in fact, entitled to the money sought. This concept of an inherent duty to make reasonable inquiry before submitting a claim to the government is reflected in the better reasoned caselaw. See, eg., United States v. Cooperative Grain Supply Co., 472 F.2d 47 (8th Cir. 1973). A more detailed explanation of the Department's endorsement of this standard is set forth in the attached December 11, 1985 letter to Senator Charles McC.Mathias.

B.

The burden of proof in civil false claims cases is another area where legislative clarification is necessary to resolve ambiguities which have developed in the caselaw. Some courts have required that the United States prove a violation by clear and convincing, or even clear, unequivocal and convincing, evidence, United States v. Ueber, 299 F.2d 310 (6th Cir. 1962), which we have found to be the functional equivalent of a criminal standard. Because the False Claims Act is basically a civil, remedial statute, the traditional "preponderance of the evidence" standard of proof is appropriate.

With respect to both of these points, it is important to keep in mind that the civil, double-damage remedy of the False Claims Act is remedial, designed to permit the government to recover money improperly paid out, and not penal or punitive. This was long ago recognized by the Supreme Court which held that:

> ...the chief purpose of the statutes here was to provide for restitution to the government of money taken from it by fraud, and that the device of double damages plus a specific sum was chosen to make sure that the government would be made completely whole.

United States ex rel. Marcus v. Hess, 317 U.S. 537, 551-2 (1943). Single damages alone would not reimburse the government for its loss of the use of funds or costs of investigation and prosecution, nor would they serve the obvious deterrent purpose envisioned by Congress.

However, this crucial principle -- that a civil False Claims

Act prosecution is remedial and not punitive -- may be jeopardized by proposals to increase greatly the penalties which may be recovered. We have found that where judges perceive the penalties which may be assessed under the Act to be grossly disproportionate to the wrongdoing, they will rule against the government outright or subtly engraft criminal standards and procedural hurdles onto the civil portions of the Act. Consequently, we are very concerned about the proposals contained in some bills, notably H.R. 3317 and H.R. 3753, as well as S. 1562, to move to treble damages and a $10,000 forfeiture. We believe that double damages plus a $5,000-per-claim penalty is more appropriate and consistent with the fundamental purpose of the statute.

C.

The Administration's bill contains numerous other amendments which were designed to resolve specific problems which have arisen under the Act:

- First, as noted above, the Administration's bill raises the fixed statutory penalty for submitting a false claim from $2,000 to $5,000. The $2,000 figure has remained unchanged since the initial enactment of the False Claims Act in 1863.

- Second, our bill amends the Act to permit the United States to bring an action against a member of the armed forces, as well as against civilian employees. When the Act was first enacted in 1863, the military was excluded because the government had available more severe military remedies. Since then, however, experience has shown that the False Claims Act should be applied to servicemen who defraud the government -- just as it is to civilian employees.

- Third, the Administration's bill contains an amendment to the False Claims Act to permit the government to recover double the amount of any consequential damages it suffers from the submission of a false claim. For instance, where a contractor has sold the government defective ball bearings for use in military aircraft, the government could recover not only the cost of new ball bearings, but the much greater cost of replacing the defective ball bearings. *See*, *United States v. Aerodex, Inc.*, 469 F.2d 1003 (5th Cir. 1972).

- Fourth, our proposal provides that an individual who makes a material misrepresentation to avoid paying money owed the government would be equally liable under the Act as if he had submitted a false claim. For instance, the owner of a HUD-insured property or his agent may falsely understate income and overstate expenses in order to increase the Section 8 subsidy which must be paid by HUD at the end of each month. This amendment would eliminate current ambiguity in the caselaw by clearly authorizing the extension of liability to such misrepresentations.

- Fifth, the Administration's bill would allow the federal government to sue under the False Claims Act to prosecute frauds perpetrated on certain grantees, states and other recipients of financial assistance. A recent decision, United States v. Azzarelli Construction Co., 647 F.2d 757 (7th Cir. 1981), has created some confusion with respect to whether the federal government may recover in grant cases where the federal contribution is a fixed sum. There is no dispute that the federal government may bring a False Claims Act case where its grant obligation is open-ended, since, in that case, every dollar lost to fraud will require an additional federal contribution. The amendment would make clear that the United States may bring an action even under grant programs involving a fixed sum.

- Sixth, our bill creates a new, uniform remedy to permit the government to seek preliminary injunctive relief to bar a defendant from transferring or dissipating assets pending the completion of False Claims Act litigation. Currently, the government's prejudgment attachment remedies are governed by state law. A uniform federal standard would significantly enhance the government's remedies and avoid inconsistent results.

- Seventh, the Administration's bill modernizes the jurisdiction and venue provisions of the False Claims Act to permit the government to bring suit not only in the district where the defendant is "found," (the current standard) but also where a violation "occurred". Currently, when multiple defendants live in different districts, the government may be required to bring multiple suits, a time-consuming process that is wasteful of judicial resources.

- Eighth, the bill modifies the statute of limitations to permit the government to bring an action within six years of when the false claim is submitted (the current standard) or within three years of when the government learned of a violation, whichever date is later. Because fraud is, by nature, deceptive, such tolling of the statute of limitations is necessary to ensure that the government's rights are not lost through a wrongdoer's successful deception.

Finally, our bill provides that a *nolo contendere* plea in a criminal prosecution, like a guilty plea, would estop a defendant from denying liability in a civil suit involving the same transaction. Defendants who cheat the government by making false claims, and then enter a *nolo* plea, should not be able to relitigate the question for civil purposes.

D.

Another important amendment contained in the Administration's bill is the grant of Civil Investigative Demand, or CID, authority to the Civil Division to aid in the investigation of False Claims Act cases. As in all complex, white-collar fraud cases, investigative tools are critical to the success of a case. We currently rely in large part on FBI reports and matters referred for prosecution by the various Inspectors General. Our investigative capacity would be greatly ided if our attorneys could compel the production of documents or take depositions prior to filing suit. CID authority would permit us to focus our resources better as well as to winnow out those cases which have little merit.

The CID authority contained in section 105 of H.R. 3334 is nearly identical to that available to the Antitrust Division under the Hart-Scott-Rodino Act of 1976, 15 U.S.C. 1311-1314. The statute would work as follows: where the Assistant Attorney General of the Civil Division believes that a person has access to information relating to a False Claims Act investigation, he may, prior to filing a complaint, require the production of documents, answers to interrogatories and oral testimony. The CID could, if necessary, be enforced in district court, like any other subpoena. The standards governing subpoenas and ordinary civil discovery would apply to protect against disclosure of privileged information.

In the only substantive difference from the Antitrust Division's authority, the Administration bill would permit the Civil Division to share CID information with any other federal agency for use in furtherance of that agency's statutory responsibilities. These might include enforcement of environmental and safety laws, banking regulatory laws and suspension and debarment actions.

In an effort to place some limited safeguards on the sharing of such information with other agencies of the government, the Senate Judiciary Committee amended the bill to require the Justice Department, as custodian of the CID information, to seek an order from a United States District Court before information could be shared with another agency. Such an order would only be granted if the Department could show that the agency seeking the information had a "substantial need" for the information in the fulfillment of its statutory responsibilities. Presumedly, the Department could move for such an order on an ex parte basis.

This requirement would be burdensome to both the Department and the courts, without, in our view, adding any meaningful protection for those who submit information pursuant to a CID. Instead, we would suggest that where an agency seeks CID information from the Justice Department, it be required to file a written statement with the Department and that the Assistant Attorney General be required to make a determination that sharing the information would substantially aid the agency in carrying out its statutory responsibilities.

III

The next point I will address, Mr. Chairman, is that of the citizen suit, or qui tam,[1] provisions of H.R. 3317 -- identical to those contained in Senator Grassley's bill, S. 1562, as introduced. The False Claims Act, since its inception, has contained provisions permitting informers to come forward with evidence of fraud on the government, file suit in their own name, and keep a share of any recovery. These provisions were adopted at a time when the government had practically no investigative resources -- unlike today, when the FBI and the Inspectors General generate most of our cases. Nonetheless, the qui tam statute occasionally motivates an informer to come forward with a meritorious suit, which the Department can then prosecute in the name of the United States. Hence, we have not proposed any changes to the qui tam provisions of the Act in our bill. H.R. 3317, however, does propose a number of changes in the qui tam provisions of the Act, and we have serious objections to those proposed changes.

---

[1] Qui tam is from the Latin, meaning "who as well". Thus, when an informer files such an action, it is said that he brings the action "for the state as well as for himself," because he may be personally awarded a portion of the judgment granted to the government.

Our first concern is with that portion of the bill which provides that even after the Justice Department has stepped in to litigate a qui tam action on behalf of the United States, "the person bringing the action shall have a right to continue in the action as a full party on the person's own behalf." Since both the United States and the relator (the person who brought the action) are pursuing the same claim, this presents a serious problem, i.e., who will control the litigation?[2] It also creates the potential for collusive litigation, since an associate of the defendant could bring a qui tam suit and then remain in the action to frustrate effective prosecution. If enacted, this provision could create enormous difficulties and seriously hamper our civil fraud enforcement efforts.

---

[2] We note that under the Federal Rules of Civil Procedure, unrelated parties may intervene in a lawsuit, (thus giving rise (CONTINUED)

If Congress wants to permit the relator to remain involved in the action in order to protect his stake, this could be done in another manner which does not raise these problems. We would suggest that the relator be kept abreast of developments in the case by receiving copies of all court filings and that he be permitted to file with the Court his objections or views on any proposed settlement by the government. This is analogous to a provision in the current statute which only permits a qui tam action to be dismissed if the Court and the Attorney General give written consent and their reasons for consenting. 31 U.S.C. § 3730(b)(1). Such a solution would provide an appropriate role for the relator without interfering with the Department's prosecution of the case.

---

[2] (FOOTNOTE CONTINUED)

to litigation with several "parallel" plaintiffs) but each such "intervenor" represents a separate, distinct interest. We are aware of no precedent in which two parties represent the identical interest in the same suit.

Another serious problem is posed by the provision permitting a relator to bring an action based on evidence available to the government, and to proceed with the action even where the Justice Department chooses not to enter the suit. The Act currently forbids such "parasitic" actions by "bounty hunters" and, in fact, was amended by Congress in 1943 to address just this problem. In the early 1940's, a rash of suits were brought which merely restated the allegations in the government's criminal indictment in an effort to make a windfall. Such practices were criticized by Justice Jackson in U.S. ex rel. Marcus v. Hess, 317 U.S. 537, 557-558 (1943) and moved the Attorney General to write to Congress proposing the deletion of the entire qui tam section. Congress responded by enacting the current prohibition on parasitic actions, codified at 31 U.S.C. § 3730(b)(4). See, United States v. Pittman, 151 F.2d 851, 853-54 (5th Cir. 1945) for a summary of the legislative history of the 1943 amendments.

H.R. 3317 would amend the Act by permitting the relator to proceed with an action based upon information known to the United States (including information disclosed in ongoing criminal or administrative proceedings as well as allegations arising out of congressional investigations and public information disseminated by any news media) if the Justice Department had not initiated any action within six months. The language of the amendment would seem to permit the government to move for an extension of time in which to decide whether to take over an action upon a showing of good cause, but this provision would be difficult to apply in practice. In effect, the civil frauds section of the Justice Department would have to be aware of all allegations of fraud when they became public knowledge in order to protect the interests of the United States in such litigation.

There are several legitimate reasons why the Department might choose not to bring a civil action on the basis of information in its possession. There may be an ongoing criminal case or investigation which would be jeopardized by a civil suit. Or, by holding off and conducting a more detailed investigation, the government may be able to make a better case or bring in other defendants. Finally, the allegations may involve conduct which is not clearly improper, and hence, which the Department, in the exercise of its prosecutorial discretion, does not believe should be prosecuted.

It is this latter problem which is most troublesome. In recent years, we have seen a growing number of frivolous qui tam actions brought against public figures for political motives. Members of Congress, Executive Branch officials and even the President have been sued on the basis of publicly available information which raises questions about the expenditure of federal money.

Most such cases have been dismissed on the basis of the current statute which prohibits the courts from exercising jurisdiction over any action which is "based on evidence or information the Government had when the action was brought". 31 U.S.C. 3730. However, if this section is deleted from the Act, (as it would be under H.R. 3317) we can expect a significant increase in frivolous, politically-motivated lawsuits. There is no evidence that the Justice Department is neglecting meritorious False Claims Act suits. Accordingly, we believe that such an open-ended expansion of private standing is entirely unjustified.

H.R. 3317 would also raise the relator's share in any recovery from the current maximum of 10% where the government takes the case and 25% where it does not, to 20% and 30% respectively. Obviously, any such recovery comes out of the federal treasury, and hence we strongly oppose any change. The bill also creates a new class of recovery for relators who can be said to have "substantially contributed to the prosecution of the action". Such persons would receive "at least 20% of the proceeds of the action". As an initial matter, we note that this provision, while providing an additional award to the more diligent relator, will inevitably result in litigation over whether a relator's actions "substantially contributed" to the government's success. We believe the prospects for such collateral litigation (not unlike that we see in the attorneys fees area) is not a productive use of resources, and believe that any additional marginal incentive such a "substantially contributed" category would provide is outweighed by the confusion and litigation it would generate. In any case, if the "substantially contributed" category is retained, there should be an upward limit on the amount of the relator's recovery, just as there is for the relator who prosecutes the entire action himself.

In conclusion, the Department has strong reservations about any change in the qui tam provisions of the Act. Following lengthy discussions with members of the Senate Judiciary Committee, the qui tam provisions in S. 1562 were modified in a way that permitted the Justice Department to support Judiciary Committee passage of S. 1562. However, we still object to any change in the current statute. The qui tam provisions are particularly sensitive in that they grant automatic legal standing for any individual to bring a fraud action on behalf of the United States. This provision can be, and has been, abused to bring frivolous and politically motivated lawsuits.

Finally, let me turn to the Program Fraud Civil Penalties Act. The Administration's bill, H.R. 3335, like H.R. 2264, would establish an administrative forum to prosecute the submission of false claims and false statements to the United States.

My comments on the legislation will be directed primarily to H.R. 3335, the Administration's bill. Congressman Heftel's bill, H.R. 2264, is nearly identical to S. 1566, Senator Roth's bill of the 98th Congress. While H.R. 2264 accomplishes much the same thing as H.R. 3335, we suggest that the Committee work from H.R. 3335 in its deliberations.

We believe that a mechanism for resolution of many fraud matters through administrative proceedings is long overdue. Many of the government's false claims and false statement cases involve relatively small amounts of money compared to matters normally subject to litigation. In these cases, recourse in the federal courts may be economically unfeasible because both the actual dollar loss to the government and the potential recovery in a civil suit may be exceeded by the government's cost of litigation. Moreover, the large volume of such small fraud cases which could be brought would impose an unnecessary burden on the dockets of the federal courts.

Several cases illustrate the types of matters for which these administrative proceedings are best suited.

> -- We brought a False Claims Act suit against several real estate brokers and a mortgage company for fraudulently inducing the Veterans Administration to guarantee three mortgage loans. The VA sustained damages of $13,100 on the three loans. While we ultimately recovered well in excess of that amount under the False Claims Act, the congested nature of the district court's docket meant that the litigation took over six years to conclude.
>
> -- Numerous matters are referred to the Department involving, for example, FHA-insured home improvement loans obtained through fraud, social security or CHAMPUS benefits obtained through misrepresentations regarding eligibility, or fraudulent overcharges on small contracts in which traditional civil and criminal litigation are simply impracticable because of the size of the government's claims and the large number of such cases.

Administrative resolution of such small cases will, in our view, address this problem by establishing an expeditious and inexpensive method of resolving them. At the same time, administrative resolution of smaller cases would permit a more efficient allocation of the resources of the Department of Justice, thus enhancing the Administration's efforts to control program fraud.

Fortunately, legislative efforts in this area can be guided by the experience of the Department of Health and Human Services under the Civil Money Penalty Law, 42 U.S.C. 1320a-7a, a similar administrative money penalty statute which has been in effect for several years. Under that law, HHS has recovered over $18 million in fraudulent overcharges under the medicare and medicaid programs. Inspector General Kusserow and the entire Department are to be commended for their efforts. HHS's successful experience testifies to the great savings which could be achieved if this authority were extended government-wide.

As with the False Claims Act Amendments, a particularly important issue posed by this legislation is the element of scienter necessary to prove a violation. Obviously, this bill should include the same standard as would apply under the False Claims Act. Therefore, we recommend that the Committee adopt the compromise, developed by the Senate, discussed in Part II of my testimony.

We believe that the administrative proceedings outlined in section 803 of H.R. 3335 preserve full due process rights, including the rights to notice, cross examination, representation by counsel and determination by an impartial hearing officer, and thus will withstand constitutional challenge. The use of a hearing examiner, or Administrative Law

Judge, to compile a factual record and make an initial determination is a common, legally unobjectionable method to administer federal programs. Critics of the use of hearing examiners can point to no legal precedent questioning this administrative hearing mechanism, and, in fact, it has consistently been upheld against court challenge. *See*, *Butz v. Economou*, 438 U.S. 478, 513-4 (1978); *NLRB v. Permanent Label Corp.*, 687 F.2d 512, 527, (Aldisert, C.J., concurring).

Criticism of the hearing examiner's supposed lack of independence conveniently ignores these well established precedents as well as several protections built into H.R. 3335. While the hearing examiner would be an employee of the agency, section 803(f)(2)(C) of the bill assures the hearing examiner an appropriate level of independence by providing that he shall not be subject to the supervision of the investigating or reviewing official, and could not have secret communications with such officials. The bill thus incorporates the generally accepted protections required by the Administrative Procedure Act. And, of course, any adjudication of liability under this bill would be subject to independent review in the Court of Appeals by an Article III judge.

In light of the Supreme Court's holding in *Atlas Roofing Co. v. Occupational Safety and Health Administration*, 430

U.S. 442 (1977), we do not believe that these proceedings would violate the Seventh Amendment's guarantee of trial by jury. In Atlas Roofing, the Court rejected a Seventh Amendment challenge to the administrative penalty provisions of the Occupational Safety and Health Act of 1970 because it concluded that Congress had created new rights which did not exist at common law when the Amendment was adopted. The Court held that:

> when Congress creates new statutory "public rights," it may assign their adjudication to an administrative agency with which a jury trial would be incompatible, without violating the Seventh Amendment's injunction that jury trial is to be "preserved" in "suits at common law".

430 U.S. at 455. The rights created here are not co-extensive with any common law cause of action known when the Seventh Amendment was adopted. In addition, we believe that this statute may, like the False Claims Act, be characterized as a "remedial" statute imposing a "civil sanction". See United States ex rel. Marcus v. Hess, 317 U.S. 537 (1943). Given these considerations, the administrative proceedings do not deny unconstitutionally trial by jury.

With respect to this last point, I note that some have suggested that because this bill and our False Claims Act Amendments provide for double damages, they can no longer be viewed as "remedial" and, instead, must be classified as "punitive", presumedly requiring a criminal standard of intent and burden of proof. However, this analysis of the bills is overly-simplistic and does not comport with traditional practice and applicable precedent, including several decisions of the Supreme Court.

Double damages serve an appropriate remedial purpose in several respects. Because of the deceptive and concealed nature of fraud, the government will rarely be able to prove the entirety of its loss. Thus, by establishing a form of "liquidated damages," this provision insures that the government will be made whole. Second, the double-damages provision partially compensates the government for its costs of investigation and prosecution. Finally, this provision has a socially useful deterrent effect.

In 1943, the Supreme Court was called upon to decide just this issue relative to a nearly identical provision in the False Claims Act. The Court unequivocally ruled that the double damage provision of that Act was a permissible statutory enactment, civil and remedial in nature and consistent with other statutes, such as the treble damage provisions of the civil antitrust laws. Writing for the Court, Justice Black stated:

> We cannot say that the remedy now before us
> requiring payment of a lump sum and double

> damages will do more than afford the government complete indemnity for the injuries done it. *** Quite aside from its interest as preserver of the peace, the government when spending its money has the same interest in protecting itself from fraudulent practices as it has in protecting any citizen from the frauds which may be practiced upon him.

U.S. ex. rel. Marcus v. Hess, 317 U.S. 537, 549-50 (1943). See also, Day v. Woodworth, 54 U.S. (13 Howard) 361, 371 (18561); Missouri Pacific Railway Co. v. Humes, 115 U.S. 512, 523 (1885).

Finally, questions were raised in the last Congress as to the effect which a finding of liability under this Act would have on a subsequent administrative proceeding to suspend or debar a contractor. In the past, such an amendment has been proposed with the stated objective of preventing the use of a civil penalty judgment in debarment or suspension proceedings. We believe that amending the bill to deny any evidentiary value to a civil penalty judgment in any administrative, civil or criminal proceeding is wholly inappropriate. The civil penalty proceedings envisioned by the bill will afford a full measure of due process protections, as well as the opportunity for judicial review of the proceedings. In view of this consideration, we believe that there is no justification for disturbing the normal rules of res judicata and collateral estoppel, and requiring another tribunal to go through the costly exercise of retrying the same facts that have already been established under the same standard of proof in a civil penalty proceeding.

In addition, we believe that it is important to note that a contractor would always be free to argue the question of remedy in a suspension or debarment proceeding. According res judicata or collateral estoppel effect to the facts underlying a civil penalty judgment in a later suspension or debarment proceeding would not necessarily establish that suspension or debarment was the appropriate remedy. A contractor would still have the opportunity to argue that he should not be suspended or debarred and that some lesser sanction -- or no sanction at all -- should be imposed.

Finally, the Department is strongly opposed to provisions, such as section 803(d)(2) of H.R. 2264, which permits Inspectors General and other investigatory officials to use compulsory process to obtain testimonial evidence as part of an investigation. Under the existing provisions of the Inspector General Act of 1978, Inspectors General are authorized to compel production of documentary evidence. Neither the Inspectors General, nor the Federal Bureau of Investigation -- the government's principal law enforcement investigatory agency -- currently issue investigative subpoenas to compel testimony. The potential for the unlimited exercise of testimonial subpoena powers during investigations might raise due process issues as well as interfere with the criminal investigation process. In addition, there would be no central coordinating authority so as to ensure consistency of standards and implementation. In this manner, section 803(d)(2) could adversely affect coordinated law enforcement. Consequently, the Administration strongly urges the Committee to reject any proposal to grant the Inspectors General the power to compel testimony when investigating fraud allegations.

That concludes my prepared statement, and I would be happy to answer any questions.

U.S. Department of Justice

Office of Legislative and Intergovernmental Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

DEC 11 1985

Honorable Charles McC. Mathias
United States Senate
Washington, D.C. 20510

Dear Senator Mathias:

This is in response to your letter to Richard Willard of November 25, 1985 regarding the meaning and consistency of the various anti-fraud legislative proposals currently pending in the Senate. The two most significant bills -- Senator Grassley's False Claims Act Amendments (S. 1562) and Senator Cohen's Civil Fraud Remedies Act (S. 1134) -- are substantially similar to Justice Department proposals and are strongly supported by the Administration. We feel that it is particularly important that S. 1562 be acted upon by the Judiciary Committee in this session of the Congress so as to ensure that there is adequate time to complete congressional action next year.

As you know, the False Claims Act is the basic statute governing fraud against the United States. In the 122 years of its existence, we have identified several improvements which would enhance the ability of the United States to prosecute fraud. In addition, conflicting court decisions in the various circuits have created some confusion as to the required burden of proof and standard of knowledge, among other matters. Consequently, the False Claims Act Amendments proposed by the Department -- and largely incorporated in S. 1562 -- would resolve these inconsistencies and anomalies while also reinforcing our civil anti-fraud efforts.

However, we have also recognized that it is often not cost-effective to prosecute relatively small fraud cases in the federal courts. Consequently, we have supported Senator Cohen's Civil Fraud Remedies Act which would create a "mini-False Claims Act" authorizing an administrative remedy for frauds involving under $100,000. This bill restates the relevant provisions of the False Claims Act while also creating an elaborate administrative mechanism for the enforcement of such small fraud cases.

Because these two bills have been considered by separate committees and because they were originally conceived independently, their terms are not always identical. The Department of Justice agrees that the bills should be in harmony in their essential features. To that end, we have encouraged the staffs of the two committees to consult in order to bring their bills into conformity. As there seems to be general agreement that this should be done, we are confident that the bills will be consistent by the end of the legislative process.

The seven different formulations of constructive knowledge attached to your letter are, in our view, fairly similar. They basically reflect various stages of the congressional debate and consideration of this complex issue, particularly in the progress of S. 1134 through the Governmental Affairs Committee. The fundamental issue in designing a standard of knowledge is to reach not only defendants with actual or constructive knowledge of a fraudulent claim, but also defendants who insulate themselves from that knowledge which a prudent person should have before submitting a claim upon the Government. It is this problem of defining constructive knowledge, or of dealing with the "ostrich" -- the individual who ignores or fails to inquire about readily discoverable facts which would alert him that fraudulent claims are being submitted -- that has led to the various formulations of the standard of knowledge.

At the start of the debate, there was a broad spectrum of possible standards of culpability, as is reflected in the seven different formulations attached to your letter: an intentional scheme to cheat, only actual knowledge of falsity, gross negligence, mere negligence, or a per se liability for any misstatement. After much study and debate, a strong consensus has evolved that it is appropriate to attach special civil remedies to those who have actual knowledge of falsity and those who have constructive knowledge of it. Even with this agreement in principle, an extraordinary amount of time has been devoted to crafting a statutory standard designed to assure the skeptical both that mere negligence could not be punished by an overzealous agency and that artful defense counsel could not urge that the statute actually required some form of intent as an essential ingredient of proof.

Consideration of this issue has not always been furthered by hypotheticals, which participants in the debate sometimes have used to demonstrate the "horrors" that might result under a proposed formulation. It is probably safe to say that black and white cases are not helpful in assessing shades of gray. Under any standard, the facts are critical; frequently the outcome is determined based on colorations, nuances of circumstantial evidence, or cumulative impressions that are difficult to articulate, let alone anticipate by legislative craftsmanship.

Eventually, these various hypotheticals focused more and more on the "busy executive syndrome," i.e., on the personal liability of a high level official in a large corporation who merely signs a claim or certification prepared by subordinates, and on the hapless bookkeeper, who simply prepares a claim for submission to the government based upon the records or instructions of others. In fact, the law has managed to assess and discern the differences between the cheat and the blameless, even under a less precise statutory standard currently contained in the False Claims Act. *See, e.g.*, *United States v. Aerodex, Inc.*, 469 F.2d 1001 (5th Cir. 1972) (corporate division head held liable, chief executive officer not liable); *United States v. Priola*, 272 F.2d 589 (5th Cir. 1959) (partner, having clerical duties, found not personally liable). The Committee's formulation in S. 1134 does not distort or bias that very fundamental assessment; it does help to refine it.

The Department's initial proposals -- both in the Program Fraud bill and the False Claims Act Amendments -- simply used the "knows or has reason to know" formula. The accompanying section by section analysis explained that this would reach someone who acted in "reckless disregard of the truth in submitting the false claim" -- a formulation which we believed would cover someone who insulated themselves by design from knowledge about the truth or falsity of a claim.

Our reference to "reckless disregard" reflected the shared assumption of the Department and the sponsors of the bills that mistake, inadvertence or mere negligence in the submission of a false claim would not be actionable under either bill. In other words, in either of these two civil proceedings, the Government would have to prove something more than mere negligence, but less than specific intent to defraud. We believe that "reckless disregard" (or "gross negligence," a phrase which we believe defines the same standard of conduct) accurately captures the proper level of knowledge. There are cases, however, in which reckless disregard is construed as requiring an intentional, deliberate, or willful act -- a considerable escalation of the scienter requirement. To avoid the risk of such a misconstruction, we subsequently urged the adoption of a gross negligence standard which appears to be less susceptible to this misinterpretation. Generally, however, we found that each is used to define the other; i.e., reckless disregard often is defined as gross negligence and gross negligence frequently is said to require a reckless disregard. These terms, and "blind or total indifference," or "carelessness in the extreme," and the like all serve to focus, without any of them precisely delineating, the assessment required of the fact-finder.

Implicit in all these formulations however is our strongly-held belief that anyone submitting a claim to the Government has some duty -- which will vary depending on the nature of the claim and the sophistication of the applicant -- to make such reasonable and prudent inquiry as is necessary to be reasonably certain that he is in fact entitled to the money sought.

This concept of an affirmative responsibility or "duty" has been recognized in much of the caselaw interpreting the False Claims Act. In United States v. Cooperative Grain and Supply Co., 476 F.2d 47, 55 (8th Cir. 1973), the court held that "[t]he applicant for public funds has a duty to read the regulations or otherwise be informed of the basic requirements of eligibility." In United States v. Klein, Civ. No. 1035-51 (D. N.J. Feb. 2, 1953), a case involving a false claim arising out of the sale of substandard milk to the Government, the court noted:

> At no time did [the defendant] take it upon himself to make any investigation as to whether the milk that he was receiving was of the quality which he solemnly promised the United States Government under his contract it would receive. If he did not know that what he was delivering was not the kind of milk that was in the contract, it was the grossest kind of carelessness and negligence upon his part, for which he must assume the responsibility of knowledge.

It should be stressed that the duty of inquiry recognized in S. 1134 is expressly qualified to avoid oppressive requirements of verification. The phrase, "reasonable and prudent . . . under the circumstances," is intended by the drafters to establish a "light" obligation to inquire rather than to create a heavy duty to reverify.

Thus, the final formulation of the knowledge standard contained in S. 1134 as ordered reported by the Senate Governmental Affairs Committee embodies all of these concepts. Under it, a defendant "knows or has reason to know" that a claim was false if he had actual knowledge of its falsity or if he:

> ". . . acts in gross negligence of the duty to make such inquiry as would be reasonable and prudent to conduct under the circumstances to ascertain the true and accurate basis of the claim or statement.

This definition embodies the two fundamental concepts which any definition of constructive knowledge should contain: the Government must prove more than mere negligence and the defendant must make some limited inquiry to determine whether his claim is accurate.

One criticism lodged against this standard is based upon the inclusion of the phrase "reasonable and prudent," a term which is often associated with a simple negligence standard, the fear being that the inclusion of this phrase will result in something less than gross negligence. In fact, an assessment of gross negligence requires that the fact-finder first consider the simple negligence form of conduct against which the alleged gross deviation is to be measured. Thus, we do not view this formulation as contradictory; rather, it protects the potential defendant because it makes clear that the duty of inquiry is a limited one.

Nonetheless, if this continues to be a subject of concern, an alternative could be constructed which would provide, ". . . acts in gross negligence of the duty . . . to ascertain the true and accurate basis of the claim or statement". It could be made clear in the committee report that this is a reference to the inherent duty of a citizen to turn square corners when dealing with the government, and citing to Cooperative Grain and the other cases. Such a change would not appreciably affect the level of culpability, but would remove the initial (and false) impression that the formulation reaches conduct which does not rise to the level of gross negligence because of the reference to reasonable and prudent inquiry, *i.e.*, the apparent facial contradiction would be eliminated.

In conclusion, we believe that this last formulation of the constructive knowledge -- that contained in S. 1134 as ordered reported by the Senate Governmental Affairs Committee -- is the most precise and therefore should be adopted by the sponsors of both bills. We would be pleased to respond further should you have additional questions or wish to discuss these issues further.

The Office of Management and Budget advises us that there is no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

(Signed) Phillip D. Brady

PHILLIP D. BRADY
Acting Assistant Attorney General

cc: Senator Thurmond
Senator Biden
Senator Grassley
Senator Metzenbaum
Senator Roth
Senator Eagleton
Senator Cohen
Senator Levin

Mr. **Glickman**. Thank you, Mr. Willard.

Before I get into the specifics of your statement, in Mr. Hertel's statement which he has submitted here and will be included in the record, he provides a survey of the Department of Defense statistics on efforts to curb waste, fraud, and abuse, and it is in the Secretary's annual report to Congress for fiscal 1986, and there was a chart in which it lists investigative cases: cases closed, cases referred for prosecutive or administrative action, convictions, and then fines. It just lists them all for that year.

I might give you just a chance to look at it quickly.

Now, my question is, is that when we list for the three fiscal years cases referred for prosecutive or administrative action there is—the numbers have shown, I guess, kind of a slight decline from fiscal 1982, 1983, and 1984; the number of convictions is about 10 percent of the cases referred. But the bottom part of Mr. Hertel's statement says: What is not immediately apparent from the chart is the dismal success rate for prosecutions: 5.7 percent for 1982; 8.2 percent for 1983, and 9.8 percent for 1984. Equally striking is the comparison of the average recovery per conviction and the average recovery per case referred for action.

He goes on on his next page to talk about the average recovery per conviction, and the average recovery per case. Now, I guess I would ask you what does this all mean? I wonder if you could shed any light? I realize you are looking at it for the first time, but what does it all mean? Is this one of the reasons why you have come here asking for beefing up the civil fraud provisions?

Mr. **Willard**. Mr. Chairman, I really can't comment on the statistics, having just seen them for the first time.

But it is certainly true that there is a need for us, at the Civil Division of the Justice Department and the U.S. attorney's offices to target our resources on the most important cases. We have a limited number of resources as does everyone in the Government today. We endeavor to target those resources as best we can on the cases that involve the largest amount of money, the most serious problems.

As a result, there are some smaller cases that simply can't be pursued profitably because if we go after the small cases it means leaving the bigger case unworked. That is one of the reasons we have proposed this administrative remedy, to allow agencies like the Department of Defense, through their own administrative processes, to take care of the smaller cases and leave us able to go after the really big ones.

Mr. **Glickman**. What is the criteria by which you warrant that a case proceed now under the False Claims Act?

Mr. **Willard**. There is no rigid requirement. Basically, cases involving less than $200,000 are routinely referred to U.S. attorneys' offices for review and action. Many of those are brought by the U.S. attorneys' offices for those smaller amounts.

We consult with the client agencies and ask for their views before we decide whether to close a case or not. But as a practical matter, there are many smaller cases that we just cannot pursue because of limited resources or because we would spend more money pursuing the case than we could hope to get back.

Mr. **Glickman**. So they are just dropped then, basically?

Mr. **Willard**. Yes, they have to be dropped.

But we don't have a rigid guideline. We do bring some small cases, especially where the client agency feels that it would serve an important deterrent purpose to pursue the smaller case.

Mr. **Glickman**. In your statement you state that the penalty of $10,000 and treble damages would make the court construe the statute as penal rather than remedial in nature because the penalty would far outweigh the prohibited conduct.

I wanted to go back—the 1863 numbers were $2,000 and if you adjust that for inflation it is 8½ times that amount right now. How do you justify your categorization of a $10,000 civil fine as so high as to make the statute appear penal rather than remedial?

Mr. **Willard**. Mr. Chairman, I would like to clarify my statement; we are concerned what I would say that such a penalty might make the courts find that the statute is penal. This is obviously a line-drawing exercise in where you set the amount. Our concern is that if we go too far we run the risk of a court finding that it is penal. In prior decisions, the courts have clearly held that this act is remedial and not penal in nature. As Mr. Fish noted, we don't want to change that. We think it is very important to preserve that interpretation.

I can't say for sure the difference between $5,000 and $10,000 is going to be dispositive. What I really would like to emphasize is that there is a balancing of interest here. Obviously, we want to make sure that the Government is made whole, but as you get higher and higher, you run the risk courts might not agree that the law is merely remedial.

Mr. **Glickman**. What if you put in, let's say, a range of $5,000 to $10,000?

Mr. **Willard**. That certainly is a possibility, Mr. Chairman, and I don't want this issue of $5,000 or $10,000 to become a sticking point. I think either version is fine. We have gotten a lot of criticism from the contractor community that $5,000 is too much, and is onerous.

So, it really is a matter of balancing the interest and coming up with a number.

Mr. **Glickman**. OK. Along the same line, the antitrust laws and the RICO violations contain treble damage provisions. I wonder how you would describe the recovery under the False Claims are different? How would they differ civilly from RICO or the antitrust violations in this same vein?

Mr. **Willard**. Again, Mr. Chairman, I don't want to say that treble damages would change the nature of the act. I don't think it necessarily would. This is still a line-drawing problem. I can't say that treble damages are punitive and double damages remedial. I think you could argue treble damages is remedial also under this circumstance.

Again, I think what this committee needs to do is balance the interests and come up with a judgment. It is our judgment that leaving double damages and raising the forfeiture to $5,000 is a reasonable change. I do think that it is the kind of thing the committee can take one step at a time. We can make some increases, and then if that still doesn't seem to be adequate, we can come back later and increase it further.

Mr. **Glickman**. OK. Let me move to another area quickly.

You have proposed a modification of the current statute of limitations in the act, false claims law—adding a provision to toll the statute to within 3 years of when the Government learned of the violation seems to be a bit vague in the context of fraud litigation.

Is there a precedent in Federal law for such a statute of limitations that you are aware of?

Mr. **Willard**. Actually, Mr. Chairman, there is. The general statute of limitations for the Federal Government, 28 U.S.C. 2416(c) does include a tolling provision. The problem is the False Claims Act, as I understand it at least, has its own statute of limitations and is not subject to the general provision.

So what we are proposing to do is to conform the False Claims Act to the general rule under common law in most States, and for that matter, for the Federal Government, to provide this limited tolling period where the fraudulent conduct has been concealed, as it frequently is, from the Government, and we don't find out about it until later.

I can say, Mr. Chairman, that I frequently see requests to sue come in right on the brink of the statute of limitations, and sometimes beyond, causing us to miss out on some of the claims we could otherwise bring because it has just taken that long to discover the fraud and get a case ready to pursue. This amendment would give us a little more flexibility in bringing some cases that otherwise would be barred.

Mr. **Glickman**. Moving quickly to the knowledge of the falsity of the claim. How would you react to language that said with respect to a claim the terms "knowing" and "knowingly" mean either that you have actual knowledge of the claim or the statement is false, or that you act in reckless disregard of the duty to make such inquiry as would be reasonable and prudent to conduct under the circumstances to ascertain the true and accurate basis of the claim statement or record?

That is slightly different than the language that is in your testimony. I am not sure that the intent is any different.

Mr. **Willard**. I don't think it is either, Mr. Chairman. I think it is very close to what we suggested and is certainly a reasonable way of drawing the line.

The language we have suggested is what had been worked out on the Senate side and sometimes it is helpful if there aren't major differences to try to use the same words to facilitate getting legislation enacted.

The purpose, though, is the one that to make sure that there is some duty imposed on the contractors to take steps to assure that they are not submitting false claims. We do not want to permit them to adopt an ostrichlike attitude of pretending ignorance, or of arranging to be ignorant of the truth or falsity of the claims they submit.

On the other hand, we certainly don't want a situation where, for example, someone I'm applying for an SBA loan, makes good faith statements, and then is later held liable for what were good faith statements which turned out to be wrong. That is something we don't intend to reach, and I don't think either of the statements you read——

Mr. **Glickman**. No, it doesn't.

Mr. **Willard** [continuing]. Or the standard in our testimony would reach that situation.

Mr. **Glickman**. OK. I just have a couple more questions for you. The cap on administrative remedies—the $100,000 cap—I am not necessarily sure that that cap is absolutely needed. But I am just wondering what happens to a case that is just over the cap for which the Department of Justice declines to prosecute. Does putting a cap in there in effect create a class of cases that would go unprosecuted, or unlitigated?

Mr. **Willard**. Again, as I said before, Mr. Chairman, a lot of these line-drawing exercises can be done differently. And certainly if the committee came up with a slightly different cap, that would be very reasonable. We sort of picked that number because it seemed to us to be about right.

We don't think that number would create a class of cases that would go unprosecuted. While we don't have fixed dollar criteria for bringing cases, we chose that number having in mind the normal burdens of civil litigation. It did seem to be a reasonable cutoff between an administrative and a court process, but certainly if the number were drawn differently that would be reasonable.

I do suggest that there be a cap. The purpose of the administrative remedy is to deal with the smaller cases. I think that if we had multimillion dollar cases in the administrative process, that that would result in a lot of accretions of procedure and other burdens on the administrative process that would cause it to bog down the way the courts sometimes have.

Mr. **Glickman**. Mr. Willard, I had more questions for you but I think we will probably try to pursue these through staff so that we can get them clarified again for the record; they are factual questions. I appreciate your testimony.

Mr. Kindness.

Mr. **Kindness**. Thank you, Mr. Chairman.

Thank you, Mr. Willard. I would like to add the comment that the institutional practice of the Department of Justice not having their written testimony available, whether it is OMB's practice or the Department of Justice practice, makes it very difficult to utilize that testimony. In fact, at the moment, I find it of no value at all. If I touch upon things that you have covered in your written statement in my questioning, I am afraid I must attribute it to that. I don't know how this practice could possibly be changed, but it continues to be a source of great concern to members of, I think, all committees where this occurs.

I think with the subject matter before us this morning, it is quite understandable that there has been a short time period, for you to prepare, however this is an administration initiative that is under consideration here. I should think that the administration would know what it thinks about it. My comment is not directed so much to you, of course, personally, as to the overall institutional refusal that has persisted in one administration after another to make testimony pertinent and timely. I would certainly hope and I know you and I have had this discussion before, and there is nothing personal about it—that we can work to change it. I would certainly appreciate any suggestions as to the person or persons at OMB or elsewhere to whom to direct further comment. But in any event it

BEST COPY AVAILABLE

does seem to me that it is entirely inappropriate for the practice to continue with great regularity. I am sorry to have to mention it again, but I will each time this comes up.

Mr. **Willard**. I understand, Mr. Kindness. I, again, apologize to the committee for that. I think you are right to be concerned about the problem. It has happened before, and I have been doing everything I can to try to get our testimony in the pipeline early enough so that it can be cleared. I indicated the problem this time, but we will keep pushing and trying to improve our record certainly insofar as our appearances before this subcommittee are concerned.

Mr. **Kindness**. I certainly appreciate that.

Mr. **Willard**. I think you are very right to be complaining about it, and I really don't have an excuse.

Mr. **Kindness**. I realize there are various people involved in the process and it doesn't fall just on your shoulders.

I believe that someone much wiser than myself commented that in our Republic, if we expect to have a Government of laws and not of men, that we must rely upon compliance with the law rather than enforcement of the law.

I have been sitting here thinking about the Government Contract Disputes Act of 1978 and how it would be wiped out by the enactment of legislation like this. The administration, no matter who is in the White House, since 1978, has, it seems to me, done everything possible to avoid implementing what I believe to be the intent of the Contract Disputes Act of 1978. There are those who say, well, I think there are some improvements that were made by that—such as making a more level playing field. But certainly legislation such as this would seem to me to completely gut the Contract Disputes Act.

I would like to ask whether you believe that a contract dispute—a claim that was being pursued before a Board of Contract Appeals—might conceivably be pre-empted by the provisions of either one of these two bills proposed by the administration? For example, during the process of a Board of Contract Appeals proceeding, if the Government claimed that there was fraud instead of a good faith dispute, wouldn't the Contract Disputes Act procedure be made useless?

Has there been consideration of that in the Department of Justice?

Mr. **Willard**. Mr. Kindness, I don't believe that this legislation materially changes the legal landscape that we have. When the Contract Disputes Act was adopted in 1978, I don't believe that it was intended to supplant the False Claims Act. The False Claims Act was in existence long before then.

The purpose of this legislation is to fine-tune the False Claims Act to make it more effective by eliminating what we think have been some erroneous judicial interpretations that have sprung up over the years.

Mr. **Kindness**. Would you have any idea of how many cases under the Contract Disputes Act involve claims that the claim is either based on a misrepresentation, or fraud? Is there a fairly significant number of cases?

Mr. **Willard**. I don't know, Mr. Kindness, the exact numbers that are involved. I don't think that it is a significant number of cases, when you consider the total number of contracting actions that take place, and the number of disputes that arise and are resolved under the Contract Disputes Act mechanism, I think that most disputes do involve good faith and not fraud.

Mr. **Kindness**. That isn't the institutional attitude at the Department of Justice, though, is it, or at the Department of Defense, or at OMB?

Mr. **Willard**. Mr. Kindness, I feel I am getting it a little bit from both sides here today. On the one hand, the statement of Mr. Hertel is that we are not pursuing enough cases—that we are only pursuing a trivial number of cases of fraud against the Government. Now I hear the suggestion that we are pursuing too many, and that we are trying to turn ordinary commercial disputes into fraud cases. It can't be both.

Mr. **Kindness**. Yes, I suppose it could be. I think what we are talking about is the manner in which the resources of the Department of Justice are employed, and the resources of other departments, in dealing with the problem. I don't think it is a matter of saying too much or too little. I think really it is how the problems are dealt with.

I think a good faith effort has been put forward by the administration to suggest ways in which to accomplish it. I am just trying to examine carefully whether we are in the process likely to do away with something else that is appropriate and worthwhile.

Mr. **Willard**. I think your concern is certainly legitimate because we do have, as you have observed, an underlying problem of Government contracting and a need to maintain those relationships in an orderly manner. I think most Government contractors are honest and want to do a good job. It certainly is not in our interest to transform the atmosphere between the Government and its contractors into one of hostility and unnecessary adversarialness. I think that the vast majority of these disputes can be resolved under the mechanisms of the Contract Disputes Act.

It is really only a small minority of the cases that are referred to us and pursued as fraud cases. We do not propose to change that basic structure. We think the False Claims Act is a sound law, generally. It has stood the test of time. What we want to do is to fine-tune the act so that it will apply the way we think it ought to apply and eliminate some of these erroneous judicial interpretations of the act, and then to create in addition an alternative dispute resolution mechanism, if you will, an administrative remedy, under the False Claims Act. The same legal standards would apply to the administrative remedy. It would not be some new standard. It would be the same as the False Claims Act, but it would be a different mechanism.

Mr. **Kindness**. Would you be in favor of making that two-way? Or a simpler approach to claims against the Government being handled in a simpler administrative way?

Mr. **Willard**. If you are talking about government fraud on contractors, I don't think that you can say there needs to be, or should be, absolute equivalence. One of the problems the Government has is that it is not a profit-making enterprise. So the Government's relationship with a contractor is not the same as an ordinary commercial relationship between two corporations.

We have to have—and I think our laws have recognized for many years, since the time of the False Claims Act—special provisions to protect the Government and the taxpayer against having their money wasted or taken by fraud. These are aside from the normal commercial remedies that companies have when they deal with each other.

Mr. KINDNESS. I would certainly agree. We definitely want to have appropriate ways to promptly deal with problems of fraud—program fraud or individual cases, whatever it may be. In contract law, I would think we have one set of circumstances that can deal with that. And in criminal law, maybe there is the need for improvement. But this area of civil remedies is the area I think that most concerns me particularly since it seems that we are trying to create a hybrid. which may be kind of treacherous to deal with. I think we need to examine it closely.

Let's turn away from contracts now to those situations in which the Program Fraud. I mentioned in discussing the matter with Mr. Fish, small business loan applications. But let's test a broader variety of areas: veterans' benefit cases, Social Security benefit cases, disability cases and the like. In particular, perhaps; I am interested in any of a great variety of areas of interaction between the United States and citizens which would seem to be covered by the provisions of these bills but particularly the Program Fraud bill—and that would include tax cases, presumably as well.

Would you care to comment as to whether as a matter of policy it is intended by the administration to extend this bill that broadly, or are we really talking about a more restricted application?

Mr. WILLARD. It is intended to apply broadly. Now, with regard to tax cases, it is my understanding that under the Internal Revenue Code, IRS already has administrative and civil remedies that are actually more draconian than what we are proposing in these bills. So it is highly unlikely that the IRS would want to use these remedies when they have even better remedies already available to them.

However, for that reason, I can't see any problem in exempting tax matters from coverage by this legislation on the theory that other remedies exist.

But with regard to the other variety of Government programs that you are stating, it is certainly our intention to cover those. We already, under the False Claims Act, go after people who try to defraud the Government—not only defense contractors, but people who are Government grantees and beneficiaries, people who try to defraud us in the Small Business Administration, or EDA Loan Programs, and other programs of that nature.

Basically, this act is intended to apply broadly, anyone who fits within the standards of the act and is trying to defraud the Government of money. It would supplement whatever other remedies may exist under the specific laws dealing with those programs.

Mr. KINDNESS. OK. Just one other area of concern here, I guess. Administrative law judges—the use of administrative law judges in the Program Fraud Civil Penalties Act. Does the administration have any reservations about the independence of administrative law judges with respect to the handling of such cases? And is there

BEST COPY

any need to establish greater independence of administrative law judges in the context of this H.R. 3335?

Mr. **Willard**. I don't believe so. Administrative law judges and hearing examiners already consider matters of enormous importance and significance around the government cases ranging from Social Security claims all the way up to cases involving international trade issues, and rate regulation involving millions of dollars. It is not at all unusual for administrative law judges to hear very important and significant cases.

We are satisfied that they can handle this kind of case under existing law without any changes.

Mr. **Kindness**. Even though they would be, in these cases, dealing with a lot of the rights of individuals, presumably on a wholesale basis, with a review being only to a Court of Appeals in the Federal court system with the administrative standard of review applicable? Unless an amendment were to be made; here, are you certain that an adequate level of protection of individual rights exist?

Mr. **Willard**. I believe so, Mr. Kindness. This system applies with regard to all kinds of other cases that involve individual rights that are adjudicated under this pattern now. The Federal Trade Commission, for example, can impose rather serious penalties administratively. And those matters are decided by administrative law judges and reviewed by the courts under the same standard. It is a rather common feature of the way our Government operates.

The reason we would oppose any change in the standard of review with regard to these cases is that as you start adding on more and more of these safeguards, it begins to look more and more like a Federal District Court proceeding. The purpose here is to create an inexpensive alternative remedy for dealing with these smaller cases. For example, if you had de novo review of these cases in the Federal courts then you really might as well have the cases heard by the courts in the first instance in Federal court. That is why we think the standard of review and the procedural safeguards currently contained in the bill are proper.

Mr. **Kindness**. Thank you.

Mr. Chairman, I realize my time is expired. I would just like to make it clear that I am greatly concerned about the whole thrust of these proposals, and will strongly urge the subcommittee to not act too precipitously on marking up these bills. We are treading a path that is going to be one that needs to be tread very cautiously, I think, particularly as to welfare recipients, food stamp recipients, small business loan applicants, and other such federal program recipients. All of those things that have to be considered in this very broadly applicable legislation and not just government contractors.

This seems to me to be one of the most sweeping ideas for reducing the Federal budget that I have ever come across. I congratulate the administration on coming up with such an idea. I am a little concerned about its application, however.

I yield back, Mr. Chairman.

Mr. **Glickman**. I might just point out for the record that some of your concerns may be for naught if the administration's budget requests get their way because you won't have a Small Business Administration and you might not have a lot of other government agencies, so there won't be anybody to worry about in those cases.

Mr. **Kindness**. Anyone with common sense wouldn't want to do business with them under these conditions, I think.

Mr. **Glickman**. Mr. Berman?

Mr. **Berman**. That would be a way to handle them.

Mr. Willard, a couple of questions regarding your prepared testimony on the qui tam provisions.

I am trying to understand the concern you have about letting the taxpayer plaintiff continue with the litigation after the Justice Department joins it. Aren't there many situations now where through processes of intervention people with similar interests participate in civil litigation? What is the nature of the problem? Is this so unusual that the individual who discovered the information—perhaps at great risk to his or her personal livelihood and has come forth with it, and has moved ahead with it—and the Justice Department now decides there is merit in that case and joins it, why should we drop the individual plaintiff from that litigation?

Mr. **Willard**. For one thing, under existing law, intervention normally requires independent basis of standing. Just because someone doesn't like the way the Justice Department is litigating a case, they can't—even as a taxpayer—intervene and try to handle the case differently.

Now, obviously, this statute gives them a piece of the action—a percentage stake in the recovery—which would be adequate to give them standing. But there still is the problem of the handling of litigation, which in this area can be quite complex.

In my experience as a trial lawyer, I have found that it is very difficult to try a case by committee, where you have different people pulling in different ways. Of course, it is sometimes unavoidable where you have multiple parties.

It is our view that the best way to prosecute a case is with a unity of control and strategy in terms of deciding who should be deposed, what kinds of questions to answer, what kinds of discovery to engage in, what theory of the case to try. If you have the private party participate separately, there is the possibility of infighting, and of different strategies being pursued with the defendant ultimately ending up as the beneficiary, able to play one side off against another.

In addition, I raised the possibility of collusion, whereby someone who is not entirely unfriendly to the defendant will file one of these claims as a way of pre-empting the government from filing its own False Claims Act suit thereby permitting him to deliberately interfere with the efficient conduct of the case.

Mr. **Berman**. That confuses me a little. You are saying that a person will bring information to the Justice Department that they may not have had regarding fraud that is so persuasive that it will convince the Justice Department to sue to recover under the False Claims Act. And that there is a reasonable or likely prospect that that person was doing it in fact to be able to participate in that litigation, in order to scuttle the litigation that arose from the information that he brought to the Justice Department which convinced the Justice Department that fraud was taking place?

Mr. WILLARD. He might figure that the Justice Department would stand a good chance of uncovering the information anyway, and do that as a pre-emptive strike. I am not saying this is going to happen every day but it is a possibility.

Mr. BERMAN. In the calendar year 1985, how many False Claims Act judgments did the Justice Department obtain?

Mr. WILLARD. I don't have that statistic here. We can supply it for the record.

Mr. BERMAN. I think it would be useful.

[The information follows:]

U.S. Department of Justice

Office of Legislative and Intergovernmental Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

10 APR 1986

Congressman Dan Glickman
Chairman
Subcommittee on Administrative
Law and Governmental Relations
Committee on the Judiciary
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

This is in response to your letter of February 24, 1986 requesting information about the Department's handling of civil False Claims Act cases.

The following statistics on our civil fraud caseload is subject to several caveats. First, our statistics are kept by fiscal year rather than calendar year, and for some of the requested categories, we have no figures. Although we believe that our statistics for Fiscal Years 1984 and 1985 are complete and accurate, statistics for Fiscal Year 1983 are incomplete and less accurate. Moreover, the most recently compiled statistics are through the end of Fiscal Year 1985. We also maintain no statistics on the disposition of matters that we delegate to the United States Attorney's offices, which are generally matters involving less than $100,000.

Our statistics on "matters received for review" includes a formal written request from a Governmental agency that we initiate suit, or a copy of a memorandum prepared by the FBI that we routinely review for possible civil fraud aspects of the matter reported, or an early report by the Defense Contract Audit Agency (DCAA) of suspected irregular conduct. However, we exclude matters where we receive no written communication and all matters under $100,000 that are taken directly to a United States Attorney. Naturally, the likelihood that a matter will develop into a civil fraud action varies greatly among these sources of referral.

Our initial review of a matter results in it being either opened and assigned to an attorney to be personally handled out of the Civil Division, referred to a United States Attorney to handle under our supervision, delegated to a United

States Attorney for handling in his sole discretion, or closed or declined for civil fraud purposes. Some of the matters that are opened are assigned to a non-attorney to monitor while further investigation of fraud continues.

Even after a matter is opened and assigned, further investigation may result in its closing without litigation. The reasons for closing are varied. We close cases because the allegations are insufficient to state a claim, the allegations are not substantiated or there is insufficient evidence of fraud, there was no loss or claim for federal funds, the amount is de minimus, uncollectible, or restitution is being made, the matter is more appropriately handled administratively, or because civil action is otherwise not warranted or advisable.

Once a matter is assigned and if it is not closed, it can be settled either before or after suit is filed. After suit is filed, we obtain recoveries through either settlement or judgments. In this context, the following table sets forth the relevant numbers requested:

ACTION TAKEN	FY 1983	FY 1984	FY 1985
Matters received for review	3690	2850	2734
Matters delegated to United States Attorneys	487	232	224
Matters opened and assigned to DOJ Attorney	204	194	212
Matters in which suit was authorized	N/A	31	59
Complaints filed	N/A	21	36
Matters settled or judgments obtained*	N/A	70	54
Open, assigned matters pending at year-end	1029	736	918
Matters for which review was not complete at year-end	1626	1580	1093

---

[*] Settlements may involve cases which were authorized for suit the previous year or which were actually filed in court in previous years. While most settlements occur after suit has been authorized, some precede that authorization and the proposed settlement is the first official action recorded.

We do not have precise statistics on *qui tam* suits filed under the False Claims Act. Nonetheless, we have identified a large enough number of such cases so that the overall picture, described below, should be accurate and reliable.

I. Cases Brought by Private Citizens in Which a Recovery Was Obtained

United States ex rel. Hollander v. Congressman William Clay, 420 F. Supp. 853 (D.C. 1976). This case was brought by a law student based upon an article in the *Wall Street Journal*. The suit contended that the defendant had falsified claims to Congress for reimbursement of his travel to and from his district. The Department took over the case and, after the defeat of defendant's several legal challenges to the Government's claim discussed in the cited opinion, the defendant paid the Government's full loss, which was $1,754. We also recovered similar amounts from approximately seven other congressmen prior to suit arising from the same general allegations.

United States ex rel. Sita v. Litton, Civil No. S-81-0440(C) (S.D. Miss.). This suit was brought by a former Litton employee who alleged that the company was charging costs associated with commercial seagoing oil rigs to Navy contracts. The Government took over the lawsuit and eventually settled with the contractor for $149,796.

United States ex rel. Gravitt v. General Electric Company, Civil No. C-1-84-1610 (S.D. Ohio). A former employee charged that G.E mischarged overhead costs to Government contracts as direct costs and altered timecards to switch direct labor expenses from commercial to Government contracts. We assumed responsibility for the case and now propose to settle it for $234,000. The relator has challenged the basis of the settlement and the issue is pending now before the court.

II. Cases Brought by State Authorities under the False Claims Act's Qui Tam Provisions

Under the Medicare/Medicaid program, both state and Federal funds finance payments to medical providers. A number of states with active medical care integrity programs have sued to recover fraudulently obtained overpayments, utilizing state law to recover the state's contribution and the *qui tam* provision to recover the Federal share, thereby combining in one Federal district court lawsuit a demand for the entire loss incurred under the program. In some of these cases, the United States has taken over the lawsuit; in others, the state has been allowed to prosecute the action. Briefly, these cases may be summarized as follows:

State	Principal Defendant	Amount Recovered or Judgment Obtained
Colorado	Buss	$ 8,249
	Bushanan	100,000
	Sancier	40,000
	Stein	76,000
Oklahoma	Okla. Children's Shelter	630,000
	Koronis	63,600
Ohio	Merit Drugs	37,577
	Newark Nursing	3,375
	Sandy's Ambulance	76,000
	Stallings Ambulance	12,041
Illinois	Dr. Alaska	1,121,551

The Dr. Alaska judgment is of dubious collectibility, but is nonetheless of interest because Illinois has a state False Claims Act which mirrors the Federal Act's substantive provisions, while allowing the recover of treble damages and forfeitures. The decision is reported as, United States ex rel. Fahner v. Dr. St. Barth Alaska, 591 F. Supp. 794 (N.D. Ill. 1984).

III. Other Qui Tam Cases

The following cases might be considered "frivolous"; whether that characterization is accurate or not, they appear to have purposes other than or in addition to the recovery of money for the United States.

Lippincott ex rel. United States v. McGovern, Humphrey, Muskie, McCloskey, Civil No. __________ (D. D.C.). Plaintiff contended that defendants wrongfully accepted pay and other emoluments from the United States Congress while engaged in non-legislative duties; i.e., a campaign for the presidential nomination.

United States ex rel. Tecton v. James E. Carter, Civil No. 76-799-A (E.D. Va.). Stripped of what the court termed "abusive language," the complaint asserted that defendant President-elect Jimmy Carter violated the False Claims Act by accepting peanut crop subsidies and payments under the Federal Election Campaign Act.

United States ex rel. Thompson v. Wayne Hays, 432 F. Supp. 253 (D. D.C. 1976). This suit, and two others filed within five days of each other, charged Congressman Hays with the submission of false claims in connection with the employment of Elizabeth Ray; one relator also sought to obtain all royalties from Ray's book.

United States ex rel. Anthony R. Martin-Trigona v. Gerald Ford, Civil No. 76-1374 (D. D.C.). This suit charged presidential candidates Ford, Carter, and Reagan with accepting illegal campaign contributions which were then "matched" under the Federal Election Campaign Act, and sued President Carter for using Government property; to wit, Air Force One, for personal or political campaign purposes.

Using the False Claims Act, Mr. Trigona has also sued Richard Daley, Mayor of Chicago (Civil No. 76-1164, N.D. Ill.); Arthur Burns and the Federal Reserve Board (Civil No. 76-0455, D. D.C.); and others.

United States ex rel. Joel Joseph v. Howard Cannon, 642 F.2d 1373 (D.C. Cir. 1981). Here, plaintiff alleged that Senator Cannon utilized a Senate employee, his administrative assistant, for his re-election campaign and paid him with Federal funds in violation of the False Claims Act.

United States ex rel. W. Edward Thompson v. Paul Pendergast, Civil No. 76-7006 (D. D.C.). This suit charged that the House of Representatives' Sergeant-at-Arms and an Assistant Sergeant-at-Arms accepted Federal pay in return for performing no House-related duties or for assisting the Democratic Campaign Committee.

United States ex rel. U.S.-Namibia v. African Funds, 585 F. Supp. 632 (S.D.N.Y. 1984). This suit challenged an apparent rival organization's entitlement to receive funds from the United Nations in alleged violation of the False Claims Act. In the next case, the same plaintiff challenged the defendant's tax-exempt status, also under the False Claims Act. 588 F. Supp. 1350 (S.D.N.Y. 1984).

Public Interest Bounty Hunters v. Board of Governors of Federal Reserve System, 548 F. Supp. 157 (D.C. Ga. 1982). This lawsuit attempted to utilize the False Claims Act to compel bank regulators to examine allegedly unsound banking practices at non-party banks.

Uberoi and the United States v. University of Colorado, Civil No. 82-M-806 (D. Colo.). This 100-page complaint names 65 present or former officials or faculty members as defendants and evidently arises because of the denial of a tenured position to plaintiff. Plaintiff's False Claims Act theory apparently derives from the fact that some employee salaries and other university costs are defrayed by Government contracts and research grants and plaintiff was denied the opportunity to audit such costs.

Some of the above cases were dismissed under the former version of what is now 31 U.S.C. § 3730(b)(4), which provides for dismissal if the Government does not take over the lawsuit and it had the information or evidence before suit was filed. In many cases, however, it was necessary for the defendants to retain private counsel to deal with the litigation. It is this consistent misuse of the existing statute to support frivolous, and often politically-motivated litigation which forms the basis for our strong opposition to changes which would further liberalize the qui tam provisions of the Act.

We do not have precise statistics on the number of claims under the fraud provisions of the Contract Disputes Act. Nevertheless, we are aware of only two such claims that have been litigated in the courts: United States v. Thompkins, (W. D. Okla.) unreported, and United States v. Williams, Civil Action No. 81-1459 (W. D. La.). We also currently have under consideration several matters where there is a possible fraud claim under the CDA. It is not yet clear whether any of these matters will result in suit being authorized for such a claim.

Sincerely,

Jl R Bolton

John R. Bolton
Assistant Attorney General

Mr. **Berman**. I have talked to staff of the subcommittee and they are going to ask you to get these statistics and this information for us. I think the extent of the weight that should be given to these concerns is best determined by how the Justice Department has done without those provisions of qui tam and those changes in qui tam that you are opposing here. I think that will give us the best evidence of some of your arguments in that regard.

Second, I would be interested in this question of frivolous claims—your concern regarding the ability of the taxpayer to bring suit when the government had evidence or information available to it that it wasn't pursuing.

Do you find the Federal Rules of Civil Procedure inadequate in the area of the ability of courts to impose sanctions on frivolous suits of this kind?

Aren't there serious remedies available, and used to a much greater extent than ever before by the courts to protect against those kinds of frivolous suits?

Mr. **Willard**. Certainly, there are remedies available under the Federal Rules where it can be shown that a suit was truly frivolous. A lot of unmeritorious cases that are brought, however, and impositions of sanctions under the Federal Rule is fairly rare. Again, I don't have the statistics but I think the number of times that unsuccessful plaintiffs, or their lawyers have actually been subjected to these sanctions have been few.

In the Civil Division, we win the vast majority of cases that are brought against us and yet, it is very rare that the people who bring those unmeritorious cases are actually subjected to sanctions.

Mr. **Berman**. We are not talking about suits here against the Justice Department, as I understand it.

The Grassley bill has a provision which gives specific statutory authority to the judge to order attorney's fees to the defendant. Where a suit is found to be frivolous or brought for harassment, wouldn't that take care of the problem?

Mr. **Willard**. I don't know that it would take care of it. I think there would still be the potential for abuse of it. That provision certainly is a help.

Mr. **Berman**. The existence of courts and the right to bring suit provides the potential for abuse. We are looking for disincentives to frivolous suits, and your suggestion is don't let the suit be brought. I am suggesting as an alternative, provide a significant and meaningful financial deterrent to the bringing of frivolous suits or suits for harassment purposes.

Mr. **Willard**. I understand, and I think that that is certainly a reasonable safeguard to try to include in a bill.

I think the best safeguard, against frivolous, litigation against Government contractors or employees, or other people that receive Federal grants or loans, is the one that we normally rely upon: To have the Department of Justice make a decision about whether or not to pursue these claims on behalf of the taxpayer, as we do in most other cases.

Mr. **Berman**. Then why not repeal the qui tam provisions?

Mr. **Willard**. They are there. We don't think that under existing law they cause so much trouble that it is necessary to repeal them, and they may occasionally draw forth additional information. But quite frankly, I don't think the qui tam provisions of existing law contribute very much at all to this effort.

Mr. **Glickman**. Would the gentleman yield?

Mr. **Berman**. I would be happy to yield.

Mr. **Glickman**. I don't know if there is any information in the record as to how many times these provisions have been used, but I think we ought to get that information, and I don't know if you have that or whether our staff does, but somebody.

Mr. **Willard**. Sir, we will certainly try to see if we can find it.

Mr. **Berman**. I think Mr. Willard's last comment is a very accurate one, and that is that, by and large, we do not think the present provisions of qui tam are very meaningful, and that is absolutely correct. That is at the nub of the problem—there is a general belief that as wonderful as the Justice Department is, that some combination of demands on its time, a natural tendency of large bureaucracies to insulate themselves and any other reasons that might apply, without regard to which particular party is in control, result in cases not being brought.

Now, a large number of potentially serious frauds in the area of Government contracting have taken place which have not been acted upon and qui tam offers a real potential to do something about that, to motivate the Justice Department to provide that prodding, that nudging, that will get the Justice Department into some of these areas. I think that is the whole theory of that.

In other words, would you suggest that the only reason the Justice Department has not pursued every potential fraud in the area of Government contracting is because the Justice Department was right?

Mr. **Willard**. I guess I cannot claim to be perfect—very few people can. I do think, though, that on balance we try to make a reasonable decision about protecting the taxpayers' interest in all of these cases and we do pursue claims where the Government has been defrauded.

We are currenty handling, in the Civil Division alone, about 50,000 cases involving upward of $60 to $80 billion in claims. In most of those areas, the taxpayers' protection depends upon our doing our job right, and this subcommittee and other committees of Congress conducting oversight to see that that occurs. That is the normal way the taxpayers' financial interest is protected, rather than by giving private citizens bounties for suing on behalf of the Government when they think they have a case.

I think the qui tam provisions as they now exist are largely an anachronism in an earlier age, at a time before we had an FBI and the kind of investigative resources that are now available to the Government.

Mr. **Berman**. I think the chairman's suggestion regarding getting some information on the effectiveness of the existing provisions and how much the Justice Department has pursued these false claims actions to successful conclusion in recent years will help the subcommittee to make its own judgment on that question.

I thank the chairman for the time.

Mr. **Glickman**. Thank you. Thank you, Mr. Willard, for your testimony.

Mr. **Willard**. Thank you, Mr. Chairman.

Mr. **Glickman**. We are kind of running with a tight schedule now. Our colleague Mr. Hertel is here, and I would ask him to come up and testify. I would tell you that we are going to try to enforce the 5-minute rule on questions from now on in order to accelerate the testimony. I think Mr. Hertel, then the HHS Inspector General, and then our private sector panel, and I think DOD as well. We will do our best to be out of here by 1:30 if we can meet this schedule.

Mr. Hertel.

STATEMENT OF HON. DENNIS M. HERTEL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. **Hertel**. Thank you, Mr. Chairman. I really thank the subcommittee for the opportunity to testify before you on the topic of false claims and Program Fraud Civil Penalties legislation.

I commend the subcommittee for taking up this issue and I salute my colleagues, particularly Chairman Glickman, and also the ranking member, Mr. Fish, and Senator Cohen, Senator Roth, for their work and leadership on this issue.

What we are talking about is something that all people and all people in Congress are upset about and that is waste, abuse and fraud. Specifically, in my area and what I have learned, we are talking about the protection of this Nation and national defense.

The problem really came to me a couple of years ago as a member of the House Armed Services Committee. We saw an analysis of the Department of Defense statistics on efforts to curb waste, fraud and abuse in Secretary Weinberger's annual report to Congress, which reveals a dismal success rate for prosecutions, which was earlier discussed in the testimony: 5.7 percent for fiscal year 1982; 8.2 percent for 1983; 9.8 percent for 1984. Equally striking is the comparison of the average recovery per conviction and the average recovery per case referred for prosecution or administrative action.

In fiscal year 1982, the average recovery per conviction was $35,880. The average recovery per case referred for action was $2,060. In 1983, the average recovery per conviction dropped to $22,500. The average recovery per case referred for action also dropped to a mere $1,845.

In 1984, the average recovery per conviction did increase to $53,250. The average recovery per case referred for action increased to $5,260. The number of cases referred for action, however, dropped 2,477 cases from the previous year, or 31 percent, from 1983 to 1984.

These figures have twofold significance. The first aspect is an apparent failure of legal deterrence. The Congress has made vast resources available for our Nation's defense. Three hundred billion dollars have gone to the Nation's defense in their yearly budget.

From 1981 to 1983, the backlog of unspent funds awaiting selection of a contractor rose by 79 percent from $24 billion to $43 billion. Figures for 1984 show no decrease in this problem.

This creates a fertile environment for corruption. The chances of being convicted are small, or penalties are only a few thousand dollars, the risk versus financial reward weighs heavily in favor of charging $9,000 for a single allen wrench.

The second aspect of DOD waste, fraud, and abuse statistics bear directly upon today's hearing. It is clear that the average case pursued by DOD and Justice falls far below the jurisdictional cap of $100,000 found in any of the Program Fraud Civil Penalties bills.

In May 1981, GAO issued a study that indicated 61 percent of the cases referred to the Justice Department were declined for prosecution. Budget cutbacks since 1981 and projected through the remainder of the decade show little hope for improvement. Assessing both the GAO and DOD statistics, there is little doubt that our Government's efforts to stem waste, abuse, and fraud have not been effective.

It is vital that we pass Program Fraud Civil Penalties legislation. We must enact the tools for expeditious but fair prosecution of these cases. To fail to act is a genuine threat to our national security both economically and militarily, because clearly this money that is taken in fraud and wrongful use could be used for our Nation's defense.

Finally, it is essential that protection for employees who report violations must be strengthened. The front line in law enforcement is always the honesty and integrity of our citizens. Deterrence really is the key and I support the committee taking up this issue and acting effectively on this bill and other ideas. The fact is that we are talking about something that is not brought up very often. These employees who work for these companies are painted with the same brush when fraud is committed by certain defense contractors—and they are very patriotic Americans, too, and they are proud of their jobs.

The employees in the Defense Department and also in private industry feel maybe even more outraged than average citizens because they are so close to the problem, and they try to do so much in other ways—that when they see people doing wrongful billing, they see fraud committed, they are outraged.

It was pointed out before that there is a difference as to how the government does business versus private business. If it was private business and there was fraud committed, the contract would be vitiated even though there was not a fraud clause in that contract. That is in contract law and common law—it has always been there, because fraud is so abhorrent to our system.

What we have seen from these statistics very clearly is, there is very little risk to the type of outrageous scandals and frauds that we have seen done especially in DOD.

I believe this type of bill should be applied as written to all departments to stem waste, abuse and fraud, using it as the basis of deterrence even with smaller Justice Department resources now and possibly in the future.

[The statement of Mr. Hertel follows:]

Statement of the Honorable
Dennis M. Hertel
Before the Subcommittee on
Administrative Law and
Government Relations of the
Committee on the Judiciary

February 5, 1986

MR CHAIRMAN:

I thank the Subcommittee for the opportunity to testify before you on the topic of false claims and program fraud civil penalties legislation.

I commend the subcommittee for taking up this issue and I salute my colleagues, particularly the ranking member of the Judiciary Committee Mr. Fish and Senator Cohen for their work and leadership on this issue.

I came to this problem a number of years ago as a member of the House Armed Services Committee. A survey of the Department of Defense statistics on efforts to curb waste, fraud and abuse in Secretary Weinberger's Annual Report to Congress for fiscal year 1986 is presented in the following chart:

	FY 1984	FY 1983	FY 1982
INVESTIGATIVE CASES			
--Cases closed	15,837	16,357	13,668
--Cases referred for prosecutive or administrative action	5,436	8,023	6,688
--Convictions	548	657	384
--Fines, penalties, restitutions and recoveries collected from referrals:			
----Justice Dept.	$18,031,000	$5,228,100	$6,717,500
----Military depts.	$11,151,000	$9,577,800	$7,062,300

What is not immediately apparent from the chart is the dismal success rate for prosecutions: 5.7% for FY 1982; 8.2% for FY 1983 and 9.8% for FY 1984. Equally striking is the comparison of the average recovery per conviction and the average recovery per case referred for action.

In FY 1982, the average recovery per conviction was $35,880. The average recovery per case referred for action was 2,060. In FY 1983, the average recovery per conviction dropped to $22,500. The average recovery per case referred for action also dropped to a mere $1,845. In FY 1984, the average recovery per conviction increased to $53,250. The average recovery per case referred for action increased to $5,260. The number of cases referred for action, however, dropped 2477 cases from the previous year, or 31%.

These figures have twofold significance. The first aspect is an apparent failure of legal deterrence. The Congress has made vast resources available for our nation's defense. Three hundred billion dollars have inundated a procurement system which has been unable to properly manage it. From 1981 to 1983, the backlog of unspent funds awaiting selection of a contractor rose by 79% from $24 billion to $43 billion. Figures for 1984 show no decrease in this problem. This creates a fertile environment for corruption. When the chances of being convicted are small, or penalties are only a few thousand dollars, the risk versus financial reward weighs heavily in favor of charging $9,000 for a single allen wrench.

The second aspect of DoD waste, fraud and abuse statistics bear directly upon today's hearing. It is clear that the average case pursued by DoD and Justice falls far below the jurisdictional cap of $100,000 found in any of the program fraud civil penalties bills.

In May of 1981, GAO issued a study "Fraud in Government Programs: How Extensive Is It? How Can It Be Controlled?" That study indicated 61% of the cases referred to the Justice Department were declined for prosecution. Budget cutbacks since 1981 and projected through the remainder of the decade show little hope for improvement. Assessing both the GAO and the DoD statistics, there is little doubt that our government's efforts to stem waste, abuse and fraud have not been effective.

It is vital that we pass program fraud civil penalties legislation. We must enact the tools for expeditious but fair prosecution of these cases. To fail to act is a genuine threat to our national security both economically and militarily.

There are other tools I hope the Committee also acts upon. I applaud my colleagues who have introduced "qui tam" legislation. This type of legislation has a fine tradition dating back to President Lincoln. It could be a very effective anti-waste weapon allowing individuals to proceed where the government has not.

Finally, it is essential that protection for employees who report violations must be strengthened. The front line in law enforcement is always the honesty and integrity of our citizens. We must encourage and protect their honesty. In conclusion. I thank you for the opportunity to address you and I ask that you act swiftly and effectively.

Mr. **Glickman**. Dennis, we want to thank you for your testimony as well as the statistics that you have contained in it. It is my judgment that we will move legislation this year along these lines. It is helpful that the Justice Department is cooperative in terms, at least sending down some language that forms the foundation for what we want to do. I appreciate the leadership that you have taken generally on defense and procurement areas. These issues affect the entire government, not just defense. In fact, we are going to have HHS testify right after you.

But the work that you have done, I think, lays a very significant foundation for the work product we finally end up with, so we appreciate it very much.

Mr. **Hertel**. I appreciate the opportunity and your support, and say that I am finally at the right place. Every time we bring these issues up in the Armed Services Committee we talk about your committee's jurisdiction, so I really appreciate your taking up the bill.

Mr. **Glickman**. Mr. Berman.

Mr. **Berman**. No questions, Mr. Chairman. I look forward to working with you on this.

Mr. **Glickman**. Thank you very much.

Our next witness is Mr. Richard Kusserow, Inspector General, Department of Health and Human Services, Office of Inspector General.

We appreciate seeing you again. I have seen you in about two or three different committees and you have been most helpful to us. We are still working on this computer security issue. I do not want to forget about that one.

STATEMENT OF RICHARD P. KUSSEROW, INSPECTOR GENERAL, DEPARTMENT OF HEALTH AND HUMAN SERVICES, ACCOMPANIED BY D. McCARTY THORNTON, SUPERVISORY TRIAL ATTORNEY, OFFICE OF GENERAL COUNSEL, DEPARTMENT OF HEALTH AND HUMAN SERVICES

Mr. **Kusserow**. Thank you, Mr. Chairman.

The last two times, in fact, I appeared before you was on the subject of securing Government computers against fraud and abuse, and I guess we are shifting a little bit here now in providing testimony on how we can secure Government expenditures against fraud and abuse. So I think we are still on the same rough track.

Mr. **Glickman**. We are delighted to have you here. I know that you have been busy. I saw your name mentioned in connection with another issue—the Medicare issue, in this morning's press. So we are delighted to have you here. You may feel free to summarize as you wish. Your entire statement will appear in the record.

Mr. **Kusserow**. Thank you, Mr. Chairman. In fact, I would like to summarize and leave maximum time for questioning.

Let me first introduce Mac Thornton who is with the Office of General Counsel for the Department of Health and Human Services, who has among his responsibilities the prosecution of civil monetary penalty cases through the administrative processes under the civil monetary penalty authority that we have pursuant to Public Law 97-35.

I trust, Mr. Chairman, that our testimony arrived in time. I would confess, though, that I did not send it over to OMB, so probably that is the reason why we did get it in timely.

In June of last year, I was called to testify before the Senate Governmental Affairs Committee on Senator Cohen's bill S. 1134, on the Program Fraud Civil Penalties Act of 1985.

At that time, I voiced our strong support for Government-wide authority to impose administrative civil penalties against individuals or entities who would defraud the Federal Government. In addition, on behalf of the President's Council on Integrity and Efficiency, I communicated the unanimous endorsement of the entire Inspectors General community for such an authority. Our support continues, Mr. Chairman.

As the Federal officials charged with the responsibility for preventing and detecting and addressing fraud and abuse issues in our respective agencies, the Inspectors General firmly believe that civil monetary penalties authority will provide a critical tool in the ongoing efforts to combat fraud against the U.S. Government.

As you know, since 1981, our Department, the Department of Health and Human Services, has enjoyed statutory authority to exercise civil monetary penalty authority and thereby levy administrative assessments and penalties against those who file false or otherwise improper claims for payment in the Medicare, Medicaid and Maternal and Child Health Programs. This represents about 10 percent of the Federal budget. This is, in fact, the first such authority and parallels very strongly all of the bills in which you are considering at this time.

I think the most tangible indication of the success of the program is the money that is being recovered as a result of this authority from fraudulent health care providers. In this regard, I am pleased to inform the subcommittee that the Department, with the positive support and cooperation of the Department of Justice, has successfully negotiated and/or imposed penalties and assessments of an average of nearly $1 million per month over the life of the authority that we have had in the Department. This has resulted in nearly $23 million from individual health service providers who abuse and defrauded our programs, and enabled that money to be returned to the Medicare trust funds and to the general revenue funds relating to those programs.

I would also like to add that the Department has prevailed in those five cases that have been administratively adjudicated before an administrative law judge with appropriate due process rights and privileges.

I would like to give a couple of examples of the kinds of cases that have gone through the process to give some sense as to how it has been applied.

We had, for example, in Florida, a chiropractor who owned and operated a clinic engaged in a large scale scheme to defraud the Medicare Program by falsely representing ineligible chiropractic services as reimbursable medical services.

In executing this scheme, that spanned several years and involved thousands of claims, the chiropractor billed for unallowable services under the names of physicians who not only never performed the services in question, but in the course of the investigation, it was determined that often times they were not even employed at the clinic at the time the claims were submitted.

As a result of that, an administrative law judge handed down a decision awarding the Department under this authority $1.8 million in penalties and assessments against that individual.

We also had another case where we had $156,000 in penalties and assessments against a Kansas nursing home operator who had included numerous false items in the cost reports and services that were in fact not being provided to the beneficiaries of the program.

We had a case of a doctor in Texas who controlled a hospital, billing Medicare for days where he did not visit particular patients and for patient visits by his daughter, who was not licensed to practice medicine in Texas. That resulted in $106,000 in penalties and assessments.

The Department also recovered $83,000 from a California psychologist, who had filed claims for 50-minute individual therapy sessions for a large number of patients. In fact, he had rendered either sessions of much shorter duration or they were group therapy sessions, both of which are reimbursed at a much lower level.

Given the record at the Department of Health and Human Services, it is not surprising that we would be strong advocates for extension of similar authority to other programs administered by our Department as well as for other agencies of the Federal Government.

For too long, many providers of goods and services to the Government have been playing a game of "catch me if you can," knowing full well that even if caught, the crowded Federal court docket minimizes their chances of being prosecuted and penalized.

We are convinced that this administrative authority is a sorely needed alternative to an overloaded Federal court system.

We are also equally convinced that a Government-wide authority, modeled along the lines of our own prototype, would provide a significant Government-wide deterrent to those who would defraud the United States.

As chairman of the Legislative Committee of the President's Council on Integrity and Efficiency, I have consulted with the IG community and asked them to supply examples of how this kind of authority could be applied in their own agencies. With your permission, Mr. Chairman, we will submit that for the record.

Mr. KUSSEROW. Several of the bills introduced to date have included a cap, which we have heard so much about today, such that there would be no jurisdiction under the bill if it were determined that the amount of money or the value of the property falsely claimed exceeded a given dollar figure. And we have heard most frequently the number $100,000 as being mentioned.

Alternatively, some bills have provided that the dollar cap applies to entire groups of related claims.

We believe that either limitation would be superfluous and would potentially gut the effectiveness of the civil monetary penalties authority.

First, existing procedures common to all of the bills would ensure that the Department of Justice has every opportunity to review each and every case and determine its suitability for civil monetary penalty action.

Prior to commencing any civil penalty proceeding, an agency must initially refer the case to the Department of Justice. The Department of Justice then has the absolute discretion to take jurisdiction of the case and proceed under criminal prosecution or under the civil False Claims Act as they see fit. Only when the Department of Justice opts not to exercise either of the options and defers this matter over, may the agency commence administrative proceedings.

To establish an additional requirement that the false claims in these cases not exceed a given dollar amount would be meaningless in itself and possibly be deterimental to the programs involved. In such cases, the discretion of the Department of Justice would be unnecessarily constrained.

In other cases involving complex programs, Justice may feel that the administrative procedures are more appropriate since the administrative law judges develop substantial experience and expertise in specialized programs under their limited jurisdiction.

Another possible unfortunate side effect of any jurisdictional cap might be that it would strip agencies of the authority to impose civil monetary penalties in those cases that should be pursued most aggressively. In short, a cap would create a possible privileged class of wrongdoers. Even in cases where the Department of Justice has declined to proceed in the court system, or for whatever reason, and has approved civil monetary penalties action, no case could be administratively brought if the amount defrauded from the Federal Government is too large. This, I think, would be an open invitation to people to say, we will steal large and get over the cap and see if you can get under the Department of Justice and thereby avoid any kind of sanction or procedure.

In effect, the cap implies the departments and agencies are not capable of rendering fair and just decisions in cases involving large amounts of money. This proposition is completely at odds with the authorities that Congress has already entrusted to a variety of governmental bodies. For example, the Office of Hearings and Appeals at the Department of Energy has been adjudicating cases worth up to a half a billion dollars per case. The Grant Appeals Board in our own Department adjudicates grant disallowance of up to $100 million. Many agencies handle administrative cases worth many millions of dollars, such as the EPA Superfund litigation, the Department of Transportation airline route litigation, FTC antitrust litigation, the Department of Labor fair labor standards, civil rights litigation, and so forth.

Even our so-called small cases in our own department, such as Social Security disability cases, involve payments worth $74,000 on the average, and that is discounted to current dollar value.

With respect to the knowledge standard, the Congress has the opportunity to enact a landmark piece of legislation—namely, to authorize the Government to impose civil monetary penalties and assessments when an individual doing business with the Government submits claims or statements that he knows or has reason to know are false.

In doing so, Congress would state that the claimants for public funds have an affirmative duty to ascertain the true and accurate basis for their claims on which the Government is asked to rely.

This duty has the primary objective of reaching those who play ostrich; that is, those who would avoid finding out the true facts underlining their claims, or the content of the applicable rules and regulations, and then seek to hide behind their ignorance. Too often we hear the plea that "The billing clerk did it," and that they really did not know what the low level people do in their own organization; and, "Nobody told me what the rules are," and things of that sort.

It is also important to make clear that those who make honest mistakes or are involved in good-faith disputes with the Government will not be penalized. As with our CMPL statute at HHS, the burden of proof is on the Government to demonstrate knowledge or a reason to know of either the false claims or the willful concealment of material information.

In order to protect himself, an executive of a company needs only to conduct such steps as are reasonable or prudent under the circumstances to assure the accuracy of their claims.

The third issue of particular concern to the IG's is the the testimonial subpoena power for investigating officials. For the following reasons we believe strongly that such authority would provide a critical tool ininvestigating fraud against the Government.

Successful fraud investigations require proof that, one, certain representations were made; two, those representations were false, and; three, the person making the representations had actual or constructive knowledge of their falsity.

Except inthose rare cases in which one obtains a direct confession from the subject, knowledge or intent is very difficult to prove. Typically, knowledge is proved by showing the facts and circumstances surrounding the preparation and submission of the claims. However, few wrongdoers leave a sufficient paper trail to enable proof of knowledge through the documents alone. Therefore, an investigator must obtain information concerning directions, instructions, and conversations among the subjects and their employees, clients, business associates, and so forth.

In most cases, witnesses and participants in the conversation are under the influence or control of the subject as a result of employment or contractual relations. They are, as a rule, reluctant to injure their position with the subject. Where these employees and other witnesses feel that they are not in a position to submit voluntarily to an interview, testimonial subpoena authority would provide an essential tool to overcome their reluctance to provide evidence.

Three additional points should be noted with respect to testimonial subpoenas. First, the authority to compel attendance and testimony of witnesses in the course of investigations is by no means unusual in the executive branch of Government. Congress has conferred such power in 68 specific statutes upon a number of Federal departments and agencies.

Second, legitimate due process safeguards to protect the individual whose testimony is compelled may be included in the grant of subpoena power.

Third, a subpoena could not be enforced independently. An IG would have to seek, first, the concurrence and assistance of the Justice Department, and then a Federal district court would have to be persuaded to issue an order enforcing the subpoena.

Finally, I wish to discuss the basis for calculating the penalty amount under civil monetary penalties authority. The statute in effect at the Department of Health and Human Services authorizes the imposition of a $2,000 penalty for each item or service falsely claimed. However, some of the bills under consideration by Congress would authorize only a single penalty of $5,000 or $10,000 for the entire claim, regardless of the number of false line items or statements included therein.

Thus, where a contractor submits a progress report containing dozens of false line items valued at hundreds of thousands of dollars, he may nonetheless be subject to only one $5,000 or $10,000 penalty for the entire claim.

Failure to authorize a penalty for each false item or source would invite aggregating some of these claims in order to beat the system and this represents a possible major loophole.

In conclusion, Mr. Chairman, let me again emphasize our support for extension of civil monetary penalties authority to all agencies throughout the Federal Government in a manner that is modeled on our existing experience at HHS.

Based upon that experience, we believe that such legislation, if enacted, would greatly enhance the ability of the United States to remedy and ultimately to deter fraud. We are, of course, ready to provide any assistance we can to you and the subcommittee to further refine the language in any of the bills that you have under consideration.

[The statement of Mr. Kusserow follows:]

STATEMENT OF RICHARD P. KUSSEROW
BEFORE
SUBCOMMITTEE ON ADMINISTRATIVE LAW AND
GOVERNMENTAL RELATIONS

COMMITTEE ON THE JUDICIARY

HOUSE OF REPRESENTATIVES

February 5, 1986

Mr. Chairman and members of the subcommittee, I am Richard P. Kusserow, Inspector General of the Department of Health and Human Services. I would like to thank you for the opportunity to appear before you this morning to provide you with an overview of our civil monetary penalties program (CMP) established under P.L. 97-35. From our experience, we may be able to offer some suggestions for developing a similar Government-wide program.

In June of last year, I testfied before the Senate Governmental Affairs Committee on the bill, S. 1134, the "Program Fraud and Civil Penalties Act of 1985." At that time I voiced my strong support for Government-wide authority to impose administrative civil penalties against individuals or entities who defraud the Federal Government. In addition, on behalf of the President's Council on Integrity and Efficiency, I communicated the unanimous endorsement of entire statutory Inspectors General (IG) community for such authority. Our support continues, Mr. Chairman. As the Federal officials charged with the responsibility for preventing and detecting fraud and abuse in our respective agencies, the IGs firmly believe that civil monetary penalties authority will provide a critical tool in the ongoing efforts to combat fraud against the United States.

As you know, since 1981, the Department of Health and Human Services (HHS) has enjoyed statutory authority to exercise civil monetary penalty authority and thereby levy administrative assessments and penalties against those who file false or otherwise improper claims for payment in the Medicare, Medicaid and Maternal and Child Health programs. This first civil monetary penalty statute can serve as a prototype for possible Government-wide application. Through the combined efforts of the various components of the Department - the Office of Inspector General, the Office of the General Counsel, the Grants Appeal Board, and the Office of the Under Secretary - the program, to date, has proved to be a highly useful tool in sanctioning wrongdoers and recouping for the health trust funds and general revenue, those unjust enrichments acquired through false or fraudulent claims. Furthermore, evidence suggests that our program is having a significant effect on deterring fraudulent and abusive conduct in our programs.

The most tangible indication of the success of this program is the money recovered from fraudulent health care providers. In this regard, I am pleased to inform the Subcommittee that the Department, with the positive support and cooperation of the Department of Justice, successfully negotiated and/or imposed penalties and assessments of an average of nearly $1 million per month since the implementation of the program. The following table itemizes and indicates the stages of the proceeding at which the penalties or settlements were recovered or obligated.

175: Total Cases In Which Action Has Been Completed

161 cases:	Settled prior to issuance of a Demand letter	$19,347,824.25
14 cases:	Demand Letters issued	
	1 case: respondent defaulted	468,524.00
	8 cases: settled after receipt of demand letter and prior to hearing	388,300.00
	5 cases: where hearing is completed	2,181,012.00
		$22,385,660.25
		Total

In addition, another 23 cases involving an estimated $2.3 million have been retained by the Civil Division of the Department of Justice for possible recovery under the False Claims Act.

The above table is noteworthy for two reasons. First and foremost, it demonstrates the success of the program in dollars and cents. Second, the table illustrates that the vast majority of cases have been settled prior to an hearing, thereby minimizing administrative costs.

I would also like to point out that the Department has prevailed in those five cases that have been administratively adjudicated before an Administrative Law Judge with appropriate due process rights and privileges. The following cases are illustrative of the kinds of fraudulent conduct that may be successfully sanctioned under our CMPL authority:

o A chiropractor who owned and operated a clinic in Florida, engaged in a large scale scheme to defraud the Medicare program by falsely representing ineligible chiropractic services as reimbursable medical services. In executing this scheme, that spanned several years and involved thousands of claims, the chiropractor billed for unallowable services under the names of physicians who not only never performed the services in question, but were no longer employed by the clinic at the time the services were rendered. The Administrative Law Judge handed down a decision awarding the Department nearly $1.8 million in penalties and assessments against the chiropractor. The criminal aspects of the investigation are still on-going, pending grand jury review.

- The Department was also awarded $156,136 in penalties and assessments against a Kansas nursing home operator who had included numerous false items in his cost reports. The operator created false invoices to support fictitious entries in the reports. There had been a successful criminal prosecution in this case; however, without CMPL, much of the unjust enrichment wouldn't have been recouped.

- A Texas doctor, who controlled a hospital, billed Medicare for days where he did not visit particular patients and for patient visits by his daughter, who was not licensed to practice in Texas. The Department was awarded $106,000 in penalties and assessments. I would like to point out that the U.S. Attorney deferred criminal prosecution in favor of proceeding administratively under CMPL.

- The Department also recovered $83,776 from a California psychologist, who had filed claims for 50-minute individual therapy sessions for large number of patients. In fact, he had rendered either sessions of much shorter duration or group therapy sessions, both of which are reimbursed at a much lower rate per patient. The psychologist also pled guilty to numerous criminal charges brought against him by the State Attorney General.

Given the record of the CMPL program at HHS, it is not surprising that we are strong advocates for the extension of similar authority to other programs administered by our Department as well as to other agencies throughout the Federal Government. For too long, many providers of goods and services to the Government have been playing a game of "catch me if you can", knowing full well that even if caught, the crowded Federal court docket minimized their chances of being prosecuted and penalized. We are convinced that this administrative authority is a sorely needed resolution alternative to an overloaded Federal court system. We are equally convinced that such Government-wide authority, modeled along the lines of our prototype, would provide a significant Government-wide deterrent to those who would defraud the United States.

As chairman of the Legislative Committee of the PCIE, I have consulted with the IG community on the proposed legislative alternatives. The following is a brief description of some broad categories of cases that would appear appropriate for administrative resolution.

o CASES THAT HAVE BEEN INVESTIGATED AND REFERRED TO THE DEPARTMENT OF JUSTICE FOR CRIMINAL PROSECUTION, BUT SUCH PROSECUTION WAS DECLINED, AND NO CIVIL ACTION WAS UNDERTAKEN.

- CASES WHERE THE SUBJECT IS PROSECUTED AND CONVICTED, BUT WHERE CIVIL ACTION FOR FULL RECOVERY IS NOT DEEMED WARRANTED AS COST EFFECTIVE BY THE DEPARTMENT OF JUSTICE.

- CASES WHERE NO CIVIL ACTION UNDER THE FALSE CLAIMS ACT WAS TAKEN BECAUSE:

  A: NO MONETARY INJURY TO THE UNITED STATES COULD BE ESTABLISHED;

  B: DOLLAR AMOUNT LOST TO GOVERNMENT COULD NOT BE ASCERTAINED; AND

  C: NOT DEEMED COST EFFECTIVE TO SEEK RECOVERY UNDER COURT SYSTEM.

The above categories in which imposition of civil monetary penalties might have been suitable and efficacious is by no means exhaustive. We have included many examples in a joint statement submitted by all statutory Inspectors General in support of Government-wide authority for the civil monetary penalties for fraud. This statement was submitted to the Senate Committee on Governmental Affairs during their June 18, 1985 hearing on S. 1134. I have included a copy of this joint statement as an attachment to my written testimony today. The examples included in the joint statement bring home the fact that authority to impose administrative penalties for fraud is not merely a desirable adjunct to criminal and civil court action; in some cases, it would be our only effective sanction against entities who defraud the Government.

During the last several years, in response to the above demonstrated need for an effective administrative sanction against fraud, a number of bills authorizing the imposition of civil monetary penalties have been considered by various Committees of the Congress. Last year, under the leadership of Senators Cohen and Roth, the Senate Committee on Governmental Affairs completed work on S.1134, the "Program Fraud Remedies Act of 1985,". Similar bills have been introduced in the House indicating growing support for such legislation. The Administration has also been a strong supporter of a civil monetary penalties bill.

The debate on the various bills have centered on several provisions that we believe are critical to the efficiency of any Government-wide civil penalties authority. These principal areas of dispute are: (1) the jurisdictional limitation or "cap" on liability for a single claim or group of related claims that may be brought under the civil penalties authority; (2) the standard of knowledge necessary for imposition of penalties and assessments, (3) testimonial subpoena power for investigating officials, and (4) the basis for calculating the amount of the penalty against a wrongdoer. We believe that the position taken on each of these issues may well determine the ultimate utility and effectiveness of civil monetary penalties authority. Therefore, each is discussed in some detail below.

Several of the bills introduced to date that would authorize the imposition of civil monetary penalties, have included a "cap," such that there would be no jurisdiction under the bill if it were determined that the amount of money or the value of property falsely claimed exceeded a given dollar figure (typically $100,000). Alternatively, some bills have provided that the dollar cap applies to entire groups of "related" claims. In the latter case, jurisdiction would not lie where the aggregate false portion of all "related" claims exceeds $100,000. For the following reasons, we believe that either limitation would be superfluous, and would potentially gut the effectiveness of the civil monetary penalties authority.

First, existing procedures common to all of the bills would ensure that the Department of Justice has every opportunity to review each case and determine its suitability for civil monetary penalties action. Prior to commencing any civil penalty proceeding, an agency must initially refer the case to the Department of Justice (DOJ). DOJ then has absolute discretion to "take jurisdiction" of the case and proceed as a criminal prosecution or under the civil False Claims Act (31

U.S.C 3729) as they see fit. Only when DOJ opts not to exercise either of their options and defer the matter over, may an agency commence administrative proceedings. Further, some proposed bills on this subject would authorize DOJ to disapprove cases for civil monetary penalties proceedings, even when DOJ declines to proceed under the False Claims Act. Under these bills, an agency may only impose penalties in cases that were not accepted by DOJ for court action, and were approved by DOJ for administrative civil monetary penalties proceedings. To establish an additional requirement that the false claims in these cases not exceed a given dollar amount would be meaningless in itself and possibly detrimental to the programs involved. In such cases, the discretion of the Department of Justice would be unnecessarily restrained. In other cases involving complex programs, Justice may believe that administrative procedures are more appropriate since ALJ's develop substantial experience and expertise in programs under their limited jurisdiction.

A second possible unfortunate side effect of any jurisdictional cap might be that it would strip agencies of the authority to impose civil monetary penalties in those cases that should be pursued most aggressively. In short a cap would create a possible privileged class of wrongdoers. Even in cases where DOJ has declined court proceedings (for whatever reason), and has approved civil monetary penalties action, no case could be administratively brought where the amount defrauded from the Federal Government is too large. This result would be tantamount to a license for wrongdoers to "steal big" and avoid the consequences. It would clearly be an invitation to game the system.

Many of those who are in favor of a cap, offer a due process argument, in effect stating that the Departments and agencies are not capable of rendering fair and just decisions in cases involving large amounts of money. This proposition is completely at odds with the authorities the Congress has already entrusted to a variety of governmental bodies. For example, the Office of Hearings and Appeals at the Department of Energy has been adjudicating cases worth up to one half billion dollars per case. The Grant Appeals Board at our Department adjudicates grant disallowances of as much as $100 million. And many agencies handle administrative cases worth many many millions of dollars, such as EPA superfund litigation, the Department of Transportation airline route litigation, FTC anti-trust litigation, and the Department of Labor fair labor standards and civil rights litigation. At HHS, even our so-called "small" administrative cases, the Social Security disability cases, involve payments worth $74,000 on the average- and that is discounted to current dollar value. In short, we cannot understand the distrust of the administrative process which the "cap" represents.

With respect to the knowledge standard, the Congress has the opportunity to enact a landmark piece of legislation -- namely, to authorize the Government to impose civil monetary penalties and assessments when an individual doing business with the Government submits claims or statements that he knows or has reason to know are false. In so doing, the Congress would state that claimants for public funds have an affirmative duty to ascertain the true and accurate basis for their claims on which the Government is asked to rely. The duty should encompass both the factual basis of claims, as well as their legal basis (that is, statutory, regulatory or contractual). However, their duty should be limited to what is reasonable and prudent under the circumstances.

The genesis of this idea was the case of U.S. v Cooperative Grain and Supply Co., 476 F.2d 47 (8th Cir. 1973), where the court said that:

> The applicant for public funds has a duty to . . . be informed of the basic requirements of eligibility.

476 F.2d at 60. The court further stated:

> . . .a citizen cannot digest all the manifold regulations nor can the Government adequately and individually inform each citizen about every regulation, but there is a corresponding duty to inform and be informed.

Id at 55. This duty has the primary objective of reaching those who play "ostrich"; that is, those who avoid finding out the true facts underlining their claims, or the content of the applicable rules and regulations, and then seek to hide behind their ignorance. Too often we hear the plea that "The billing clerk did it," or "They did that out in the field," or "No one told me what the rules were."

Typically, it is the claimants who control their claim processes, and who are in a position to conduct reasonable checks to ensure that appropriate financial and billing controls for their own businesses are in place. It is unreasonable for the Government to be expected to know those claims that are proper and those that are not, to bear the risks of claims generated by sloppy procedure or untrained personnel. We might allude to the fact that IRS requires that books and records be maintained to justify various business and personal claims. Therefore, we believe the burden of making reasonably sure that claims are correct, should be placed on those who make claims upon the treasury of the United States.

It is important to understand what we are not saying here. We believe that the legislative record should be clear that those who make honest mistakes or who are involved in good faith disputes with the Government will not be penalized. As with our CMPL statute at HHS, the burden of proof is on the Government to demonstrate knowledge or a reason to know of either false claims or willful concealment of material information.

In order to protect himself, an executive of a company needs only to conduct such steps as are reasonable or prudent under the circumstances to assure the accuracy of their claims. The executive would have to have reasonably competent people for his billing process and see that they received appropriate training. Further, he should have in place appropriate audit controls and insure that periodic checks were made to see that the work was being done correctly. These are simple concepts,ones that a reasonable and prudent executive would do anyway. The statute would not add to these normal business responsibilities.

The third issue of particular concern to the IGs is that of testimonial subpoena power for investigating officials. The bills introduced to date have varied considerably on this issue, ranging from no such testimonial subpoena power, to relatively broad authority to compel the attendance and testimony of witnesses in the course of investigations. For the following reasons, we believe strongly that such authority would provide a critical tool in investigating fraud against the Government.

Successful fraud investigations require proof that (1) certain representations were made, (2) those representations were false, and (3) the person making the representations had actual or constructive knowledge of their falsity. Except in those rare cases in which one obtains a direct confession from the subject, knowledge or intent is difficult to prove. Typically, knowledge is proved by proving the facts and circumstances surrounding the preparation and submission of the claims. However, few wrongdoers leave a sufficient "paper trail" to enable proof of knowledge through documents alone. Therefore, an investigator must obtain information concerning directions, instructions and conversations among the subjects and their employees, clients, business associates, etc. In most cases ,witnesses and participants in the conversation are under the influence or control of the subjects as result of employment or contractual relations. They are, as a rule, reluctant to injure their position with the subject. Where these employees and other witnesses feel that they are not in a position to submit voluntarily to an interview, testimonial subpoena authority would provide an essential tool to overcome their reluctance to provide evidence.

Three additional points should be noted with respect to testimonial subpoenas. First, the authority to compel attendance and testimony of witnesses in the course of investigations is by no means unusual in the executive branch of Government. Congress has conferred such power in 68 specific statutes upon a number of Federal departments and agencies, such as the Department of Justice Antitrust Division, and the Department of Transportation, Commerce, Labor, Interior, Treasury, Engery, Agriculture, HUD, and HHS. A list of these authorities was compiled at the request of Senate Subcommittee on Oversight of Government Management and is available from the Subcommittee.

Second, legitimate due process safeguards to protect the individual whose testimony is compelled may be included in the grant of subpoena power. For example, specific provisions for the assistance of counsel, right of access to transcripts, right to a general statement of the scope of the investigation, and some degree of confidentiality all seem to be appropriate protections for the witness. In this regard, the safeguards included in H.R. 3334, the "False Claims Act Amendments of 1985," with respect to Civil Investigative Demands authority for the Department of Justice are an excellent model and would seemingly be adaptable to testimonal subpoena authority for IGs.

Third, a subpoena could not be enforced independently. An IG would have to seek, first, the concurrence and assistance of the Justice Department, and then, a Federal District Court would have to be persuaded to issue an order enforcing the subpoena.

The final issue I wish to discuss concerns the basis for calculating the penalty amount under civil monetary penalties authority. The statute in effect at the Department of Health and Human Services authorizes the imposition of a $2,000 penalty for each item or service falsely claimed. However, some of the bills under consideration by Congress would authorize only a single penalty (of $5,000 or $10,000) for the entire claim, regardless of the number of false line items or statements included therein. Thus, where a contractor submits a progress report containing dozens of false line items valued at hundreds of thousands of dollars, he may nonetheless be subject to only one $5,000 penalty for the entire claim. It does not make sense to permit only a single penalty simply because the false line items are aggregated in one claim, when, had the claims been submitted separately, a penalty could be levied with respect to each. Failure to authorize a penalty for each false item or source this would invite aggregating claims to "beat the system" and represent a major "loophole." This seems a classic case of elevation of form over substance.

In addition, to calculate the penalty based on each false item or service submitted more closely tailors the penalty to the culpability of the claimant. For example, the contractor in the above example should justifiably expect to face a higher penalty than would an individual who falsifies a single line item of a claim resulting in a much lesser loss to the Government.

In conclusion, let me again emphasize our support for extension of civil monetary penalties authority to all agencies throughout the Federal Government in a manner modeled on our existing experience with the CMPL at HHS. Based on that experience, we believe that such legislation, if enacted, would greatly enhance the ability of the United States to remedy and ultimately to deter, fraud. We are, of course, ready to provide any assistance I can to your Committee in its efforts to craft a strong, effective and fair bill that will meet with approval and prompt passage.

JOINT STATEMENT ON BEHALF OF
THE STATUTORY INSPECTORS GENERAL
IN SUPPORT OF
GOVERNMENT-WIDE AUTHORITY
FOR
IMPOSITION FOR CIVIL MONETARY PENALTIES FOR
FRAUDS AGAINST THE GOVERNMENT

June 18, 1985

Submitted by Richard P. Kusserow
Chairman, Legislation Committee
President's Council on Integrity
and Efficiency

With this statement, the statutory Inspectors General[1] hereby offer their unanimous support for a government-wide administrative mechanism to impose civil monetary penalties for false claims and statements made to the United States. As the Federal officials who are charged with the formidable task of preventing and detecting fraud and abuse in their respective agencies, the Inspectors General strongly believe that the proposed civil monetary penalties authority will provide an invaluable tool in their efforts to combat fraud against the United States. It will also contribute to furthering the Administration's management reform initiatives, known as Reform 88.

Under current law, the principal remedies for fraud against the Federal government are criminal prosecution and civil litigation. Both sanctions require the participation of the Department of Justice and resort to the Federal courts. However, the Justice Department simply does not possess the resources necessary to prosecute all cases referred to it by the Inspectors General and others. Further, certain cases may lack prosecutive merit for a variety of reasons -- for example, loss to the government is small or impossible to calculate; insufficient jury appeal; insufficient evidence to support a criminal prosecution; and a host of other factors. And, where the dollar value of a case is relatively small, civil litigation under the False Claims Act may be inappropriate since the Government's cost of litigation would exceed any potential recovery. Often, then, the Government is left only with the administrative remedies of suspension and debarment. Though important, these sanctions are frequently inappropriate, and do not offer the United States the opportunity to recoup its losses, both actual damages and consequential damages such as costs of detection and investigation. As a result, many instances of fraud against the government go unpunished.

---

[1] A list of the Inspectors General contributing comments for this Joint Statement is included as an Appendix hereto.

Where the Department of Justice does opt to take civil action against a wrongdoer, litigation often takes an inordinate time to pursue through the U.S. District Courts. Such "justice delayed" not only costs the government dearly in the expenses associated with protracted litigation, but also, we believe, dilutes the deterrent effect of the remedial action.

The bill under consideration by the Committee today, S. 1134, offers an alternative to judicial remedies for fraud -- an alternative that promises numerous benefits to the Federal government. First, the civil monetary penalty authority would act as a powerful deterrent, particularly in those types of cases in which the Department of Justice does not pursue civil action or criminal prosecution. Vigorous use of this sanction authority by all Federal agencies would dispel the perception that "small" frauds against the United States may be committed with impunity. Second, an administrative mechanism for resolution of fraud cases is both expeditious and relatively inexpensive. Thus, victimized agencies may move swiftly to penalize fraud, thereby protecting the integrity of the programs against ongoing fraud. Third, an administrative alternative will relieve the Department of Justice of the burden of "smaller" fraud cases, thereby freeing that Department to more effectively allocate its own resources. Such a distribution of responsibility can only strengthen the overall efforts of the Federal government to control fraud. And finally, the proposed civil monatary penalties authority would provide the government with the means of recovering sums that have heretofore been irretrievably lost to fraud.

For the above reasons, the Inspectors General would welcome civil monetary penalties as an additional tool to recover federal funds misspent as a result of false claims and statements, and to deter future fraud.

In order to emphasize the utility of and need for an administrative mechanism for resolution of fraud cases, various Inspectors General have submitted the following examples of cases -- some very specific, others, general descriptions of categories of cases -- that would appear suitable for such administrative proceedings:

National Aeronautics and Space Administration

- The President of a Small Business section 8(a) Contractor, a Chapter S Corporation, charged personal expenses through the company's overhead accounts to a NASA cost-reimbursable contract. These personal expenses consisted of false claims on public vouchers of approximately $27,000. The expenses were purportedly related to official business, when in fact they consisted of costs associated with personal use of a Mercedes Benz and a Cadillac by the corporate president and his spouse. Since government auditors disallowed the expenses on the NASA contract, the Assistant U.S. Attorney declined prosecution on the ground that there was, therefore, no financial loss to the government. Under the proposed program fraud legislation, the corporation and/or individual could be liable for a civil penalty of up to $10,000 for each false claim plus an administrative assessment of not more than double any amounts claimed.

- A contractor employee was transferred cross country to work on a NASA contract. He submitted a receipt, signed by the purported landlord, for claimed rental expenses to be reimbursed by his employer. These costs would ultimately be borne by the government under the NASA contract. In fact, the employee did not rent the apartment but merely moved in with his girlfriend. The landlord signed the false receipt as a "favor to a friend." Afterwards, the employee doctored the original receipt in order to receive additional reimbursement on a second claim. Prosecution was declined because the employee is making restitution, he had no prior criminal record, there was "minimal federal interest," and there would be a necessity to transport witnesses cross country at a cost disproportionate to the false claims totalling $1,626. Under the program fraud bill, penalties and assessments could be levied.

Department of Energy

- Based on questions raised in a DCAA audit report, the IG engaged in a two year investigation of a contractor to a DOE grantee. The contract was to provide an energy storage system to the grantee to be used in connection with a solar-powered building funded by the Department of Energy. Investigation showed that the contractor had charged numerous personal expenses to the contract. These expenses included the repayment of private, personal loans and purchase and maintenance of a Cessna aircraft as well as payment for personal travel and legal services. Due to perceived evidentiary problems, i.e., lack of identity of Federal funds, the Department of Justice declined both criminal and civil action. The procedures provided in the program fraud bill would have facilitated recovery of the substantial loss in this case.

Department of Transportation

- The bill would appear to free Federal agencies from some legal obstructions that presently exist within title 18 of the U.S. Code and the False Claims Act, such as the requirement that an injury must be sustained by a Federal agency or department. Thus, under the proposed S. 1134, the Department of Transportation would be able to bring false claims actions against bid riggers on Federal-aid highway and airport projects, notwithstanding the decision in U.S. v. Azzarelli Construction Company, 647 F.2d 757 (1981). In Azzarelli, the U.S. Court of Appeals held that in view of the fact that the Federal contribution to highway construction in Illinois for the year in question was a fixed sum, there was no monetary injury sustained by the United States to permit a recovery despite the fact that project costs had been inflated due to the bid rigging conspiracy. Where the false claims do not exceed $100,000, action could be brought under the program fraud bill. This could result in substantial direct dollar recoveries for the Department, as bid rigging investigations are their highest priority and most successful area of investigation.

Veterans Administration

- The proposed civil monetary penalties authority could be used to redress beneficiary entitlement fraud. The Department of Justice has been reluctant to pursue criminal prosecution of recipients involved in beneficiary entitlement fraud since they are often elderly or disabled. For example, during the past year, 293 VA cases involving fraud in excess of $1,000 each were declined by the Department of Justice, including 224 compensation and pension cases. The proposed penalties and assessments in this legislation could be applied in some of these cases, where the beneficiaries have financial resources to pay.

Department of Commerce

- Civil penalties authority will help in cases where no dollar loss to the government can be readily ascertained. For example, the Department has cases where contracts or financial assistance awards are based on documents that contain false statements. In many cases, the Department cannot determine the connection between the false statement and the Department's decision to enter into the contract, grant or loan. Although such an award results in no monetary loss to the government, the integrity of the procurement or financial assistance process is greatly damaged once the false statement has been uncovered. These contractors should be held responsible for their actions. A monetary penalty for this type of corruption would act as a deterrent to others who would seek to mislead the government.

Department of the Interior

- The following are examples of cases that have been declined for criminal prosecution and civil action, that would be appropriate for imposition of civil penalties under the program fraud bill. First, a contractor with the Bureau of Indian Affairs submitted inflated billings in connection with services performed under the contract. Total overbillings were in the vicinity of $40,000. Potential assessment under the civil monetary penalties bill would be approximately $80,000. Second, an insurance company submitted inflated false financial statements required to obtain a license to do business, resulting in government approval of the license application. The potential assessment under the civil monetary penalties bill would be approximately $40,000.

Department of Housing and Urban Development

- The cases at HUD that could best benefit from the proposed legislation would be diversion of funds from multifamily projects in violation of 12 U.S.C. 1715z-4, and rental assistance and single family HUD/FHA insured loan fraud cases. Penalties and assessments which could be proposed through this legislation, if enacted, could be substantial.

General Services Administration

- GSA has developed a special computer program to identify cases that would be potential candidates for action under the proposed civil money penalties authority. The chart below depicts the number of GSA OIG cases against business enterprises for which civil and criminal action was declined by the

Department of Justice. Duplication of cases has been eliminated, as have cases with identified losses in excess of $100,000.

1982	1983	1984	1985 (to 4/30)
25	22	40	13

Individual case examples from GSA follow. There are other sample cases available should the Committee wish to review them.

- Investigation disclosed 28 instances of false billings by a GSA auto repair contractor during an 18 month period with a total estimate loss to the Government of $1,042. A United States Attorney declined prosecution, because of the low dollar amount. GSA subsequently settled with the contractor for $215. As five false invoices were involved, penalties of $50,000, and an assessment of $2,084, for a total of $52,084, could have been proposed, if the program fraud bill were law.

- In connection with a courtroom renovation contract, a judge requested walnut, as opposed to birchwood, cabinets. An investigation disclosed that the prime contractor submitted a change order which was inflated by approximately $15,000. In an interview, the subcontractor who did the work, indicated that the prime had subsequently increased its estimate for a change order by misquoting the figures submitted by him. Prosecution was declined. Since only one false claim was involved, the penalty under the program fraud bill would be $2,000, and the assessment, $30,000, for a total possible recovery of $34,000.

Department of Labor

- In Philadelphia, a physician was indicted on 5 counts of filing false claims and 13 counts of mail fraud. A two-year investigation by the Labor OIG and Postal Inspection Service found that he had verified and treated disabling, work-related injuries for several postal employees, including undercover agents who were not sick but claimed they wanted time off for vacations and other reasons. The doctor had instructed his patients on how to fake injuries and how to prevent their supervisors from catching them. The doctor was sentenced to four years probation, fined $7,500 and ordered to pay $900 in restitution. He was the certifying physician on 129 disability claims, many of them fraudulent, filed by USPS employees. Under the proposed civil penalty authority, the government could have followed this criminal prosecution with administrative proceedings to recoup its losses due to this fraudulent scheme.

Environmental Protection Agency

- In one case, the EPA discovered that a local agency deliberately submitted false claims to EPA. The Department of Justice was unwilling to pursue the case on either a civil or criminal basis, leaving no penalty for such wrongdoing. The proposed legislation would allow the Federal government to take action in cases such as this, where no judicial relief is available.

Small Business Administration

- At SBA, civil monetary penalties authority could be extremely useful in combatting fraud against the Small Business Set-Aside program, wherein large companies fraudulently certify themselves as small in order to receive awards. Such cases are difficult to prosecute because loss to the government often cannot be substantiated. In addition, the civil penalties authority could be used to penalize and deter frauds against the Small Business Investment Corporation program.

Department of Education

- The greatest benefit of having civil penalty authority would be realized in the Education Department student assistance program. While thousands of post secondary schools and millions of students participate in these loan guarantee and grant programs, and while student aid appropriations account for approximately half of the Department's annual budget, dollar amounts for individual fraud cases are relatively small. These "small dollar" cases are often declined for prosecution by the Department of Justice, and in rare instances where prosecution is pursued, related costs far outweigh benefits. Audit and investigative experiences indicate that significant amounts have been obtained fraudulently under these programs. Given the alternative to adjudicate these offenses administratively, the Department could not only recoup lost funds, but could reduce instances of fraud, merely by publicizing the Department's authority to impose administrative assessments and penalties.

Department of Health and Human Services

- Current Civil Monetary Penalties authority at HHS extends only to the Medicare, Medicaid and Maternal and Child Health Programs. The proposed bill would extend this authority to all other programs administered by the Department, among them, Social Security, Public Health, Food and Drug and many

> others. The proposed authority would prove valuable in recovering from certain beneficiaries under entitlement programs. For example, we are currently investigating a physician who has been collecting disability insurance under Social Security for a number of years. Investigation has revealed that this physician billed Medicare and Medicaid in excess of $70,000 in one year while he claimed to be disabled. Should the Department of Justice ultimately decline prosecution in this case, it would be appropriate for civil monetary penalties under the proposed legislation.

We believe that the above case examples, as well as those presented by Mr. Sherick, the Inspector General for the Department of Defense in his testimony today, amply demonstrate the need for a civil penalty authority.

Certain provisions of S. 1134 of particular significance to the Inspectors General merit some comment here. First, many IGs are concerned about the provision of section 809(a) that requires each investigating official to prepare and submit to the agency head an annual report that summarizes (1) matters referred to the reviewing official, (2) matters transmitted to the Attorney General, (3) all hearings conducted, and (4) actions taken. Given the distribution of responsibility under the Act, the investigating official can easily provide current, accurate information only with respect to the first item. The remaining three matters concern actions over which the Inspectors General have no control (e.g., hearings and collection activities.) Therefore, we recommend that this provision be modified to transfer reporting responsibility to the appropriate officials. And, should the IG's retain reporting responsibility for "matters referred to the reviewing official," we suggest that this information be included in the Semi-Annual Reports of the Inspectors General.

The Inspectors General are also concerned about the inclusion in section 803(a)(2) of a "probable cause" standard for referrals by the reviewing official to the hearing examiner. Because "probable cause" is a term of art used most often in the context of criminal law, we believe that it may cause some confusion in this civil penalties bill. Therefore, in order to avoid any confusion over the use of the term, we strongly recommend that the Committee include a definition of this standard in its Committee Report.

Finally, in section 804(a)(2) the subpoena duces tecum authority granted to the investigating official has been modified to cover only documentary evidence "not otherwise readily available to the authority." We believe that such limiting language adds nothing to the existing requirements that all administrative subpoenas must be "reasonable," and will only spawn needless litigation. Current IG subpoena authority contains no such limitation. Thus, an Inspector General who issues a subpoena for information that is relevant to a number of possible proceedings (e.g., civil monetary penalties, termination of benefits, recovery of overpayments, etc.), may be in the position of needlessly arguing under which subpoena authority he or she proceeded to obtain documents. We therefore suggest that this language be stricken and that the test of reasonableness remain implicit.

In conclusion, we strongly urge this Committee to act favorably and expeditiously on S. 1134. At a time of great concern over high budget deficits, we owe it to the taxpayers and the beneficiaries of our federal programs to do whatever we can to make certain that every federal dollar is properly spent. We believe S. 1134 is one sure means of moving us toward that objective.

APPENDIX

The attached statement was drafted by the Legislation Committee of the President's Council on Integrity and Efficiency, based on comments received from the following Inspectors General:

Honorable Paul Adams
Department of Housing and
Urban Development

Honorable Herbert Beckington
Agency for International Development

Honorable Robert W. Beuley (Acting)
Department of the Interior

Honorable Bill Colvin
National Aeronautics and Space
Administration

Honorable Sherman Funk
Department of Commerce

Honorable Charles R. Gillum
General Services Administration

Honorable John Graziano
Department of Agriculture

Honorable William C. Harrop
Department of State

Honorable J. Brian Hyland
Department of Labor

Honorable Richard P. Kusserow
Department of Health and
Human Services

Honorable John C. Martin
Environmental Protection Agency

Honorable James R. Richards
Department of Energy

Honorable Frank S. Sato
Veterans Administration

Honorable Joseph Sherick
Department of Defense
(See separate testimony)

Honorable James B. Thomas
Department of Education

Honorable Joseph P. Welsch
Department of Transportation

Honorable Mary F. Wieseman
Small Business Administration

Mr. GLICKMAN. Thank you.

Just on your last point, I want to make sure I understand you—that you want to be in a position where if a contractor or somebody having business with the Government is to be penalized under this law, the penalty, the $5,000, whatever the penalty would be, would be on a per-claim basis or a per-violation basis?

Let's say I file a claim with HHS. I am the chiropractor in question. Let's say the claim is actually based upon maybe years of improper claims. Am I going to be penalized $5,000 for each improper claim or times—so it would be 5,000 times 229, or it would be one $5,000 claim?

Mr. KUSSEROW. The way it works under existing legislation in our Department would be that each and every false item or service that you have filed is a separate penalty offense, and you can be penalized for that. So what that guards against is the chiropractor in your example, hypothetical example, that might wish to avoid getting around each item or service by batching them into a single claim and thereby having a penalty which is far less than the total aggregate amount being claimed. Whereas, now, in the case of the chiropractor, each and every item or service he submits for payment would represent a separate penalty offense.

Mr. GLICKMAN. That is a definitional matter that we need to take care of.

Mr. KUSSEROW. We would be happy to work with the committee on that, Mr. Chairman.

Mr. GLICKMAN. OK.

The results of your civil money penalty program are impressive. Would most of these cases have gone unsanctioned were it not for the existence of that program?

Mr. KUSSEROW. Yes, Mr. Chairman, I think virtually all of them would have gone unsanctioned. Where you have a situation where the alternatives for remedy, for wrongful behavior, is either prosecution in the U.S. district court for criminal sanction, or for civil sanction, or nothing at all, that leaves a lot of cases that just don't make the screen.

So all the cases that we have had, in fact, did not make the screen. In fact, every single case that we had followed through for administrative assessment did go through the Department of Justice first and they did defer to us for administrative remedy rather than try to proceed under the False Claims Act.

Mr. GLICKMAN. Now, one final question I have for you. I want to know what knowledge standard do you use in your application of these cases.

Mr. KUSSEROW. The standard that we use is that they knew or had reason to know.

Mr. GLICKMAN. Is that a standard permitted under the statute?

Mr. KUSSEROW. That is correct. And by regulation it is all described as to what that constitutes.

Mr. GLICKMAN. You make the point that we had a great opportunity to do that implying that that is not, obviously, the current state of the law under the False Claims Act.

Mr. KUSSEROW. Basically what it means is that all those cases that fail to meet the criteria necessary for the False Claims Act, that the opportunity exists to take all of those cases and to bring them within the ability of the Government to recover the unjust enrichment from wrongdoers.

Mr. Glickman. I want to tell you, I appreciate your statement. Also, I appreciate the staff work that your staff has been cooperative with our office. My staff has told me how helpful the IG's office has been on these matters. I am sure we are going to try to utilize your expertise as we work up the legislative process.

Mr. Kusserow. Thank you, Mr. Chairman. We in fact will continue to provide any assistance that you may feel is warranted.

Mr. Glickman. Thank you.

Mr. Kindness.

Mr. Kindness. Thank you, Mr. Chairman. I apologize for having to be absent for a short while.

I might ask, it appears the first time I was aware of your written testimony being available was this morning. Could you tell me when it was submitted, by any chance?

Mr. Kusserow. We gave it yesterday afternoon at 2 o'clock.

Mr. Kindness. I see. We continue to have such a problem.

Mr. Kusserow. Mr. Kindness, I will apologize if that wasn't timely enough, but I can assure you I can't blame it on OMB because I didn't send it to them. It isn't their fault that that wasn't very timely. I can't blame anybody else if we needed it sooner.

Mr. Kindness. Thank you very much.

If I go over an area that has already been covered I will apologize for that.

I would like to ask whether these decisions are made in these cases under the existing law applicable to HHS, that is whether these decisions are made by administrative law judges?

Mr. Kusserow. That is correct. There is a special administrative law judge under the Grants and Appeals Board that hears these cases.

Mr. Kindness. Are those administrative law judges sort of a separate corps? Are they assigned primarily to that——

Mr. Kusserow. Absolutely. They are set aside from all other systems of administrative law judges in our Department or in the government. It is a separate branch to hear only these cases.

Mr. Kindness. Is there any different procedure that is applicable to their decisions by way of review before the agency decision is provided?

Mr. Kusserow. Yes, we have a long due process method that we follow to eventually resolve—and if you like, Mr. Kindness, I can just walk through the entire due process of the civil monetary penalties legislation we have in our own programs. The first is that when the investigators from the inspector general's office encounter false claims that have been submitted, and when the full extent of that falsity has been determined and the evidence is at hand, we permit the individual and their selected counsel to review the facts and evidence that we have. Then we attempt to reach settlement with them.

Should that fail in the process—we will say that in most cases that resolves the case, that there is an amicable agreement. Actually, I don't know how amicable it is, but it is agreed to, and that ends it.

Mr. **Kindness**. Excuse me, at that point, has there been any discovery or subpoena?

Mr. **Kusserow**. No, we don't have subpoena authority to compel testimony, although we do have the authority under the Inspector General's Act to compel production of documents. At this point, this is where the investigation has proceeded very substantially. We feel that we want to confront the individual or their counsel, show them what the facts are, and see if we can reach settlement.

If we cannot reach settlement, then we will issue a demand letter and they have a right at that point to go to an administrative hearing before an administrative law judge. The prosecutor for the government at that point is the Office of General Counsel, which is in a separate part of the Department from the inspector general. They have a due process hearing at that time. The administrative law judge renders a decision. If the individual is not satisfied with the decision, has the right to appeal to the Under Secretary of the Department, and state reasons why they feel the decision is incorrect.

If they are dissatisfied still with the result of that process, they now have a dual opportunity here. If they are dissatisfied because there is an exclusion attached to the penalty, that is, that they are going to be excluded from participation in Medicare and Medicaid as a result of this, then they go into U.S. district court and appeal on that; or if they are just concerned about the monetary amount that was decided, then they have a right to immediately go to the U.S. Court of Appeals.

So there is a tremendous number of opportunities for due process to be had before the final adjudication of the issues.

Mr. **Kindness**. In the district court, in the event that path is pursued, is that a de novo proceeding?

Mr. **Kusserow**. It goes into the Court of Appeals if it is on the issue of the amount. In other words, they may say that they have a question as to the procedures or as to what evidence was omitted, or whether they had an opportunity to exercise their due process rights, and they can appeal that directly into the Court of Appeals. In the district court it is only for the issue of the period of exclusion.

But in either case, it is not a de novo hearing.

Mr. **Kindness**. Right. Their access to the district court is strictly on——

Mr. **Kusserow**. Appeal.

Mr. **Kindness** [continuing]. Exclusion from a benefit for the future?

Mr. **Kusserow**. From participation in the programs. The Court of Appeals is for the penalties assigned under the legislation.

Mr. **Kindness**. Thank you. Thank you, Mr. Chairman, I yield back.

Mr. **Glickman**. Thank you. I appreciate your testifying. We will be working with you as we develop this legislation.

Mr. **Kusserow**. Thank you, Mr. Chairman.

Mr. **Glickman**. I am aware that our last panel is in a bit of time bind so why we don't go ahead and take you now and then the last witness will be the inspector general of the Department of Defense. So, Mr. Cross and Mr. Menaker, why don't you come up here?

I think that also Paul Besozzi is accompanying you. Mr. Cross, you are accompanied by?

Mr. Cross. Ellen Brown, U.S. Chamber.

Mr. Glickman. With the U.S. Chamber. Mr. Cross, why don't you go ahead and begin and then after you Mr. Menaker. You may feel free to summarize your statements because they will be included in the record in their entirety.

STATEMENTS OF CHRISTOPHER T. CROSS, PRESIDENT AND CHIEF OPERATING OFFICER, UNIVERSITY RESEARCH CORP., ON BEHALF OF THE U.S. CHAMBER OF COMMERCE, ACCOMPANIED BY ELLEN B. BROWN, REGULATORY AFFAIRS ATTORNEY, U.S. CHAMBER OF COMMERCE; AND FRANK H. MENAKER, JR., VICE PRESIDENT AND GENERAL COUNSEL, MARTIN MARIETTA, ON BEHALF OF AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC., ACCOMPANIED BY PAUL BESOZZI, PARTNER, LAW FIRM OF HENNESSEY, STAMBLER & SIEBERT

STATEMENT OF CHRISTOPHER T. CROSS

Mr. Cross. Fine. Thank you, Mr. Chairman. We certainly appreciate your courtesy in arranging the schedule.

I am Christopher Cross, president and chief operating officer of University Research Corp. I appear here today on behalf of the U.S. Chamber of Commerce. As I mentioned, I am accompanied on my right by Ellen Brown, who is the chamber's regulatory affairs attorney.

As you know, the chamber is the world's largest business federation of companies. Ninety-one percent of the chamber members are small firms with fewer than 100 employees, and 57 percent have fewer than 10 employees.

Many chamber members are involved in a variety of government programs through contracts, loans, and grants. We believe that the discovery and elimination of fraud in these programs are laudable goals. Moreover, we recognize that many small cases of fraud are neither investigated nor prosecuted in Federal court due to a lack of resources at the Department of Justice.

Therefore, we do not oppose the establishment of an administrative mechanism to remedy these cases. However, we must be certain that the methods adopted to achieve the goals do not overreach the government's authority over its citizens.

A variety of legislation—proposing a new administrative mechanism or amendments to the False Claims Act—have been introduced to address this complicated and frustrating problem of fraud against government agencies.

The longstanding position of the chamber is that everyone should be protected against arbitrary deprivation of their rights and that such protection should be of paramount importance to Congress in framing laws creating new remedies for administrative agencies.

In order to adequately protect individual rights, lawmakers must consider the following concepts:

First, a proper balance between governmental authority to protect the public interest and individual rights to due process in an administrative proceeding.

Second, a definition of fraud based upon intent and culpability rather than mere negligence or inadvertence.

Third, we are concerned about the lack of procedural safeguards in these administrative proceedings, to wit, no independent prosecutorial review and unlimited testimonial subpoena power.

If this legislation does not effectively address these issues—and we think the current bills in the House and the Senate both suffer from not addressing these—then we believe Congress must take great care in redrafting these provisions.

Other witnesses have gone into many of the specific legal issues of concern to all businesses. I know you have another hearing tomorrow where you will hear additional witnesses.

From a small business standpoint, I would add the following comments:

I have no problem with being held liable for intentional actions done with actual knowledge. But a statute that makes me liable for acts done negligently imposes on me a standard of conduct that is fundamentally unfair. Four of the principal proposals all seek to do just that. A business owner must have the right to rely on the word and judgment of his employees, unless he has a specific reason to disbelieve them. A standard of liability on the basis of some duty to investigate employees' actions creates a burden that no business owner can afford to implement.

We believe that legislation must provide sufficient procedural safeguards to assure equitable and impartial agency actions. These include the effective separation of quasi-judicial functions from other functions, such as investigatory or prosecutory functions.

The Government has an important responsibility when charging a company or individual with fraud. A judgment of fraud has devastating effects on a small business: lines of credit disappear; customers cease their patronage; the community's goodwill toward this business ceases.

If the judgment has been reached in accordance with due process, no business owner reasonably can complain. If, however, the judgment is reached without affording the accused the ability to prepare for trial, without ensuring independent prosecutorial review, or without providing adequate judicial review, these effects will occur unjustly.

All of the legislation currently before the Congress would create due process problems in many of these respects. For example, H.R. 3334 and the Senate bills provide government investigators with new unfettered subpoena and discovery powers to compel sworn testimony prior to the initiation of legal proceedings and without protections currently provided by law.

While one bill, S. 1134, has taken a step toward adequate appellate review, none of the bills completely ensures against abuse of the process by government officials. We believe this offends the standards of justice we take for granted in this country.

In conclusion, Mr. Chairman, we appreciate the difficult and frustrating struggle of eliminating fraud in government programs, and we commend the efforts of Congress in attempting to solve the problem. But in drafting solutions to a difficult problem, we must not permit the Federal Government to become overly powerful or abusive of important individual rights.

Thank you for this opportunity to testify. I would be pleased to answer your questions.

[The statement of Mr. Cross follows:]

Statement
# of the
Chamber of Commerce
# of the
United States

ON: FALSE CLAIMS ACT AMENDMENTS AND
PROGRAM FRAUD CIVIL PENALTIES

TO: SUBCOMMITTEE ON ADMINISTRATIVE LAW
AND GOVERNMENTAL RELATIONS OF THE
HOUSE COMMITTEE ON THE JUDICIARY

BY: CHRISTOPHER T. CROSS

DATE: FEBRUARY 5, 1986

The Chamber's mission is to advance human progress through an economic,
political and social system based on individual freedom,
incentive, initiative, opportunity and responsibility.

The Chamber of Commerce of the United States is the world's largest federation of business companies and associations and is the principal spokesman for the American business community. It represents almost 180,000 businesses plus several thousand organizations, such as local/state chambers of commerce and trade/professional associations.

More than 91 percent of the Chamber's members are small business firms with fewer than 100 employees, 57 percent with fewer than 10 employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business—manufacturing, retailing, services, construction, wholesaling, and finance—numbers more than 12,000 members. Yet no one group constitutes as much as 29 percent of the total membership. Further, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the 54 American Chambers of Commerce Abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross section of its members serving on committees, subcommittees and task forces. Currently, some 1,800 business people participate in this process.

STATEMENT
on
FALSE CLAIMS ACT AMENDMENTS
AND
PROGRAM FRAUD CIVIL PENALTIES
before the
SUBCOMMITTEE ON ADMINISTRATIVE LAW AND GOVERNMENTAL RELATIONS
of the
HOUSE COMMITTEE ON THE JUDICIARY
for the
U.S. CHAMBER OF COMMERCE
by
Christopher T. Cross
February 5, 1986

I am Christopher T. Cross, President and Chief Operating Officer of University Research Corporation, appearing here today on behalf of the U.S. Chamber of Commerce. I am accompanied by Ellen B. Brown, the U.S. Chamber's Regulatory Affairs Attorney.

The Chamber is the world's largest business federation of companies, chambers of commerce, and trade and professional associations. More than 91 percent of the Chamber's members are small firms with fewer than 100 employees, 57 percent with fewer than 10 employees. Moreover, virtually all of the nation's largest companies are also active members. We particularly are cognizant of the problems of smaller businesses, as well as issues facing the business community at large. My company is a small business, so my comments reflect that perspective.

Many Chamber members are involved in a variety of government programs through contracts, loans, and grants. We believe that the discovery and elimination of fraud in these programs are laudable goals. Moreover, we recognize that many small cases of fraud are neither investigated nor prosecuted in federal court due to a lack of resources at the Department of Justice. Therefore, we do not oppose the establishment of an administrative mechanism to remedy those cases. However, we must be certain that the methods adopted to achieve the goals do not overreach the government's authority over its citizens.

A variety of legislation -- proposing a new administrative mechanism or amendments to the False Claims Act -- has been introduced to address this complicated and frustrating problem of fraud against government agencies. The long-standing position of the Chamber is that everyone should be protected against arbitrary deprivation of their rights and that such protection should be of paramount importance to Congress in framing laws creating new remedies for administrative agencies.

In order to protect adequately individual rights, lawmakers must consider the following concepts:

- the proper balance between governmental authority to protect the public interest and individual rights to due process in an administrative proceeding;
- a definition of fraud based upon intent and culpability rather than mere negligence or inadvertence;
- the lack of procedural safeguards in these administrative proceedings, e.g., no independent prosecutorial review and unlimited testimonial subpoena power.

If this legislation does not address effectively these issues -- and we think the current bills in both the House and Senate do not -- then Congress must take great care in redrafting its provisions.

Other witnesses, I am sure, will address many of the specific legal issues of concern to all businesses. From a small business standpoint, I would add the following comments:

I have no problem with being held liable for intentional actions done with actual knowledge. But a statute that makes me liable for acts done negligently imposes on me a standard of conduct that is fundamentally unfair. Four of the principal proposals — S. 1134, S. 1562, H.R. 3317 and H.R. 3334 — all seek to do just that. A business owner must have the right to rely on the word and judgment of his employees, unless he has a specific reason to disbelieve them. A standard of liability on the basis of some duty to investigate employees' actions creates a burden that no business owner can afford.

We believe that legislation must provide sufficient procedural safeguards to assure equitable and impartial agency actions. These include the effective separation of quasi-judicial functions from other functions, such as investigatory or prosecutory functions. The government has an important responsibility when charging a company or individual with fraud. A judgment of fraud has devastating effects on a small business: lines of credit disappear; customers cease their patronage; the community's goodwill towards the business ceases. If the judgment has been reached in accordance with due process, no business owner reasonably can complain. If, however, the judgment is reached without affording the accused the ability to prepare for trial, without ensuring independent prosecutorial review, or without providing adequate judicial review, these effects will occur unjustly.

All of the legislation currently before the Congress would create due process problems in many of these respects. For example, S. 1134, S. 1562, and H.R. 3534 provide government investigators with new unfettered subpoena and discovery powers to compel sworn testimony prior to the initiation of legal proceedings and without protections currently provided by law. While one bill, S. 1134, has taken a step toward adequate appellate review, none of the bills completely ensures against abuse of the process by government officials. We believe this offends the standards of justice we take for granted in America.

In conclusion, Mr. Chairman, we appreciate the difficult and frustrating struggle of eliminating fraud in government programs, and we commend the efforts of Congress in attempting to solve the problem. But in drafting solutions to a difficult problem, we must not permit the federal government to become overly powerful or abusive of important individual rights.

Thank you for this opportunity to present our views, and I would be pleased to answer any questions.

SUMMARY OF STATEMENT

on

FALSE CLAIMS ACT AMENDMENTS AND PROGRAM FRAUD CIVIL PENALTIES

before the

SUBCOMMITTEE ON ADMINISTRATIVE LAW AND GOVERNMENTAL RELATIONS

of the

HOUSE COMMITTEE ON THE JUDICIARY

for the

U.S. CHAMBER OF COMMERCE

by

Christopher T. Cross

February 5, 1986

Many U.S. Chamber of Commerce members are involved in a variety of government programs through contracts, loans, and grants. We believe that the discovery and elimination of fraud in these programs are laudable goals. Moreover, we recognize that many small cases of fraud are neither investigated nor prosecuted in federal court due to a lack of resources at the Department of Justice. Therefore, we do not oppose the establishment of an administrative mechanism to remedy those cases. However, we must be certain that the methods adopted to achieve the goals do not overreach the government's authority over its citizens.

A variety of legislation — proposing a new administrative mechanism or amendments to the False Claims Act — has been introduced to address this complicated and frustrating problem of fraud against government agencies. The long-standing position of the Chamber is that everyone should be protected against arbitrary deprivation of their rights and that such protection should be of paramount importance to Congress in framing laws creating new remedies for administrative agencies.

In order to protect adequately individual rights, lawmakers must consider the following concepts:

- the proper balance between governmental authority to protect the public interest and individual rights to due process in an administrative proceeding;
- a definition of fraud based upon intent and culpability rather than mere negligence or inadvertence;
- the lack of procedural safeguards in these administrative proceedings, e.g., no independent prosecutorial review and unlimited testimonial subpoena power.

If this legislation does not address effectively these issues — and we think the current bills in both the House and Senate do not — then Congress must take great care in redrafting its provisions.

We appreciate the difficult and frustrating struggle of eliminating fraud in government programs, and we commend the efforts of Congress in attempting to solve the problem. But in drafting solutions to a difficult problem, we must not permit the federal government to become overly powerful or abusive of important individual rights.

Mr. **Glickman**. Thank you, Mr. Cross. I want to thank you for your concise statement where I think you made all your points without spending pages and pages and pages discussing them.

Mr. **Cross**. Thank you. I might note, we had our statement here on Monday morning at 10 as well. [Laughter.]

Mr. **Glickman**. OK. I guess the Office of Management and Budget could——

Mr. **Cross**. Doesn't have to worry about us, that's right.

Mr. **Glickman**. Mr. Menaker.

Mr. **Menaker**. Thank you.

Mr. Chairman and members of the subcommittee: My name is Frank Menaker. I am the vice president and general counsel of Martin Marietta Corp. Accompanying me today is Paul Besozzi who is a partner in the Washington, DC, law firm of Hennessey, Stambler & Siebert. We are representing today the Aerospace Industries Association of America.

The AIA believes that the goal which you are pursuing, which is to attempt to find a more effective mechanism for detecting and punishing fraudulent claims against the Government is certainly an appropiate one. We believe that this goal must be balanced against the need to maintain fundamental principles of due process in the standards and procedures employed by the Government in enforcing the law.

The association strongly believes that the Congress should proceed with deliberate caution when it comes to removing the inherent protections afforded by the judicial system.

AIA is concerned that in a number of fundamental respects the proposals disrupt this essential equilibrium and that they will lead to the erosion of fundamental due process rights.

This concern is greatest when it comes to removing the inherent protections afforded by the judicial process and substituting an administrative mechanism where the allegedly wronged agency serves as the prosecutor, the investigator, the judge, and the appellate authority.

We have four specific concerns that we are going to address, with three subconcerns. Probably no other element of the program fraud bill, and now the False Claims Act proposals, has been the subject of greater discussion and interpretation than the standard of intent or knowledge required to establish liability.

Indeed, in the AIA view, this element of these legislative proposals is probably the most critical and potentially has the most far-reaching impact.

AIA believes that a person should not be held liable for a false or fraudulent claim unless that person acts with conscious culpability. The person must have acted with actual knowledge that the claim was false, or with reckless disregard for the falsity of that claim. No lesser standard should be approved, especially for application in a broad administrative apparatus.

Reckless disregard under such a standard would cover the person who consciously and deliberately shields himself from information necessary to assess the falsity of a claim.

Reckless disregard also could encompass the person who, faced with a significant and clear risk of falsity, such as a signal that something is wrong, deliberately proceeds in conscious disregard of that risk.

AIA believes that it would be unreasonable to apply a broader standard, such as one which would generally penalize negligence or, more specifically, the failure to conduct an investigation that a reasonable and prudent person should or would conduct. Such a standard drifts far afield from traditional common law concepts of fraud.

Furthermore, application of such an inherenty subjective definition would have decidedly practical implications.

Adoption of some form of negligence standard, wrapped in a duty to investigate, could require that business people constantly—and I mean constantly—question their ability to rely upon the judgment of their fellow employees, even their most trusted associates.

Negligence, mistake, inadvertence, indeed, honest disputes with the Government, these are not the stuff on which claims or fraud should be based and severely penalized—whether it be in court or in an administrative proceeding. The standard of intent or knowledge adopted by the subcommittee should very clearly and precisely exclude such unwitting conduct from its scope.

Let me now talk about the element of the burden of proof.

The various proposals would permit the Government to establish liability for a false or fraudulent claim—whether in a court or administrative proceeding—based merely on a preponderance of the evidence. This is a clear dilution of the Government's burden of proof as currently required.

The association believes that the damage provisions of the civil False Claims Act and its administrative progeny, the program fraud bill, would fall somewhere between the criminal penalty and comprehensive recovery under a contract or common law.

In AIA's view, it is unprecedented and unfair to permit what amounts to punitive damages without a higher level of proof than that required for compensatory damages. Similar penalty levels are included in the pending program fraud proposals.

In AIA's views, these changes, when coupled with a lightening of the burden of proof, would permit the Government in effect to obtain what amounts to punitive damges without a higher level of proof than that required for compensatory damages.

We believe that the Government's burden of proof should be retained at the clear and convincing evidence level under both civil False Claims Act and any program fraud bill.

The issue of the availability of testimonial subpoena power to government investigating officials arises in two contexts in the proposals now pending before the subcommittee. In both cases, AIA's paramount concern is the need for such a powerful investigatory tool, the potential for abuse and the protections afforded those who might be the target for such subpoenas.

The first context in which this issue arises is the engrafting of a civil investigative demand mechanism for potential court proceedings brought under the civil False Claims Act.

A CID mechanism, with or without testimonial subpoena power, applied in the civil False Claims Act arena should include each and every protective mechanism afforded under the existing antitrust laws and its interpretive cases.

Finally, the subcommittee should closely examine the extent to which testimony taken in this prejudicial context should be automatically shared with other government investigators, especially those seeking to impose penalties through administrative adjudications.

The second context in which the testimonial subpoena power issues arises is the grant of such authority directly to investigators preparing for potential administrative proceedings under a program fraud statute.

AIA is opposed to such a grant, even if it is restricted to the departmental inspectors general themselves. There is just no evidence to show that such investigators truly need such independent subpoena authority to do their jobs successfully.

Moreover, without clear and precise limits on the use of such subpoenas and the data gathered thereunder, AIA believes that there is a potential for misuse in an administrative environment, where there would be decidedly less protections than afforded under the CID structure.

For example, based on the pending proposals, in the CID context the target of such a subpoena would be told up front of the allegations of conduct violating the law and would be able to seek a court ruling quashing the demand. In addition, any information collected by a CID would be specifically exempt under the Freedom of Information Act. Finally, subpoenaed testimony under such a CID could only concern documentary material or information. To AIA's knowledge, none of these fundamental protections has been included in any of the proposals for testimonial subpoena power in the program fraud context.

The import of granting testimonial subpoena power to the government's investigators is even more significant in light of the limited discovery rights available to the target of such a subpoena. There are no minimum discovery rights provided to the accused enabling adequate trial preparation.

The administration, as you heard today, wisely has been opposed to granting testimonial subpoena power to administrative investigating officials under a program fraud bill.

There also is a need for an independent assessment of prosecutorial merit. The program fraud mechanisms before the Congress generally leave to the agency allegedly wronged the task of both investigating and referring to prosecution the offenses charged. In addition, officials of the wronged agency would try the cases and the agency head generally would sit as the initial appellate judge of a decision by a subordinate.

AIA recognizes that the combination of such functions in a single agency is not without precedent in administrative law. Still, in light of the stigma of the accusations, and the severity of the penalties, at some point in the administrative process—prior to prosecution by the agency—an independent assessment should be made of the merits of the case. Most of the pending program fraud bills pay lip service to this suggestion by providing for passive approval by the Department of Justice. In our view, that is not enough. At a minimum, there should be a requirement for active approval or disapproval by the Department of Justice.

In addition to these four major items, we would like to provide comments on three other areas of concern, which include the following:

First, the program fraud proposals before the subcommittee would suggest adopting a relatively narrow standard for appellate court review. We would suggest that the Administrative Procedure Act standard be the standard required for review. Second, with regard to qui tam suits—this is a difficult subject for me to discuss. I think in principle we would agree that a qui tam suit might lie in certain cases. The problem we have with it is that it probably will encourage, or be a mechanism, for encouraging over-enthusiastic lawsuits against the defendants. I look at it as another full employment act for lawyers. I think we have to find some way to discourage that kind of activity.

We would recommend that as a mechanism for tempering such citizen prosecutors, perhaps the Congress could require that plaintiffs pay defendant's costs of fending off any qui tam suit deemed by a court to be without substantial basis.

Third, traditionally access to grand jury materials outside the criminal prosecutor's office and the court has been limited to a select group of individuals. The law and courts have been reluctant to grant expanded access to such sensitive materials without specified showings. AIA would urge the subcommittee to proceed with caution when it comes to proposals to expand such access beyond traditional borders.

Finally, there is another aspect to our position which we think warrants your consideration. It is different in the sense that it is not couched in legal terminology. Rather, it is a simple and direct appeal to the fundamental concepts of fair play and evenhandedness. While seemingly mundane, these concepts are the very underpinnings of a process in which the Government, stepping down from its sovereign throne, enters into the free marketplace to transact the business of doing business with the private sector. This is an arena in which those engaged have elected consciously and voluntarily to provide the services and material essential to our national defense.

If in the conduct of business with the Government, industry employees are obliged to assume unconscionable risk or are burdened through law or intimidation with penalties and punishments disproportionate to any offense or intended wrongdoing, then industry employees will be discouraged from participating in the arena of defense contracting. I emphasize employees.

Given the complexity of that business, the volume of transactions, the potential for innocent error, the uncertainty and vagueness of so many of the rules, the risks to industry and its employees become unbearable and could become prohibitive. This is not a threat. It is an appeal to reason.

Congress must and should discern the meaningful distinction between the risk to an individual submitting but one personally relevant claim to the Government, and the risk to the Government contractor and the Government contractor employee, who, within the course of a single contract, asserts literally thousands—hundreds of thousands, sometimes a million—transactions, each one of which can constitute a distinct claim.

When aggregated, the potential for penalty is unbounded—far greater than the penalty would be under comparative criminal and civil statutes in which the accused is assured of all the normal safeguards of due process. Quite frankly, the statistical probability for getting caught up in an accusation of civil or program fraud now appears to be inevitable.

Should you think I exaggerate the magnitude of the problem, let me note the recently accomplished OSD Task Force Conference Report on Cost Principles dated November 8, 1985. We can provide you with a copy of that report.

It was written by 20 defense "costing experts"—government employees—examining existing regulations, of which there are 48 in total. It found 38 of those 48 defective in one or more significant ways: Specificity, clarity, practicality, and effectivity—and made more than 71 distinct recommendations for DAR Council actions with the DOD.

We are not dealing with a precise science, but with general principles subject to individual interpretation colored by perception—interpretations over which even specialists and experts can and do disagree in the majority of cases. While there is room for improvement, and I believe that improvement is going on right now, and I believe that progress can and will be made, but there will always be significant areas that are imprecise.

I exhort this subcommittee to ponder the good sense and fairness of reserving the opportunity to deal with these areas in a nonadversarial forum, through discussion and negotiation at the level of the contracting officer and the auditor, as has been the past practice, rather than taint the procurement process with the aura of administrative actions prescribed by a bureaucratic tribunal dictating severe penalties, stigmatizing industry, and its employees, and making no distinction between willful misconduct, contract clause interpretations made in good faith, and honest errors of judgment.

Mr. Chairman, that concludes the AIA's prepared statement. I would ask that my full statement be included in the record. We appreciate very much your giving us this opportunity to share our opinions with you. If you have any questions we will be glad to answer them.

[The statement of Mr. Menaker follows:]

SUMMARY OF TESTIMONY OF THE AEROSPACE INDUSTRIES ASSOCIATION (AIA)

The AIA believes that the goal of ferreting out and punishing fraud against Government programs is a laudable one. But the Congress must be careful, in the process of strengthening the Government's investigatory and prosecutorial tools, not to neglect the fundamental principles and protections of due process.

AIA has fundamental concerns about elements in the bills pending before the Subcommittee (1) to amend the civil False Claims Act and (2) to establish an administrative bureaucracy for prosecuting small fraud cases.

First and foremost, a person should not be penalized for false claims based on negligent, unpurposeful conduct. There should be no liability without a showing of actual knowledge of falsity or, at a minimum, reckless disregard (involving a conscious culpability) for the falsity of a claim.

Second, the Government should be required to prove its case by clear and convincing evidence, whether in court or the administrative tribunal. This is generally the present standard under the civil False Claims Act; it should not be diluted at the same time as other elements of the Government's job in proving civil fraud are being made easier and penalties are being made more severe.

Third, there is no demonstrated need to grant testimonial subpoena power to investigating officials preparing administrative cases involving false claims. The Administration opposes these "extraordinary powers" as being without "demonstrable justification." AIA agrees. Any use of civil investigative demands authorized under the civil False Claims Act should be subjected to all of the same protections incorporated in the Antitrust Civil Process Act.

Fourth, a genuinely active, independent assessment of the merits should be made before a false claim case is tried in an administrative forum. This is not too much to ask for in return for the elimination of the inherent protections found in the judicial process.

In addition to these key areas, the Subcommittee must give careful scrutiny to the proposals on qui tam suits and greater access to grand jury materials. No changes should be approved which open the door for potential abuses justified solely on the grounds of pursuit of fraud.

STATEMENT OF FRANK H. MENAKER, JR.
ON BEHALF OF THE
AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC.
BEFORE THE
SUBCOMMITTEE ON ADMINISTRATIVE LAW AND GOVERNMENTAL RELATIONS
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON THE JUDICIARY

FEBRUARY 5, 1986

CONCERNING AMENDMENTS TO THE
FALSE CLAIMS ACT, INCLUDING
THE PROGRAM FRAUD CIVIL
PENALTIES ACT

Mr. Chairman and members of the Subcommittee, my name is Frank H. Menaker, Jr. . I am the Vice President and General Counsel of Martin Marietta. I am appearing here today on behalf of the Aerospace Industries Association of America, Inc. ("AIA" or "Association"), the trade association which includes among its members this Nation's leading manufacturers of commercial, military and business aircraft, as well as helicopters, aircraft engines, missiles, spacecraft and an array of related components and equipment. Accompanying me is Paul C. Besozzi, a partner in the Washington, D.C. law firm of Hennessey, Stambler & Siebert. AIA appreciates the opportunity to participate this morning and present its views on a most important topic. The Association is presumably only one of many organizations with opinions about today's subject matter. We hope that in developing its recommendations the Subcommittee will consider the views of a broad spectrum of similar interested parties and their representatives. I would ask that my full statement be included in the record of these hearings.

I. INTRODUCTION

No one in good conscience can logically criticize any reasonable effort, legislative or otherwise, to prevent or root out fraudulent claims against Government programs. AIA is no exception.

There are many laws and regulations on the books designed to deal with possible fraudulent activity in Government programs. Indeed, according to the American Bar Association's ("ABA") Section of Public Contract Law, the government contract area, for example, is "already covered by more than 400 statutes, and regulations that provide the Government with criminal, civil and administrative remedies" for fraud. 1/

II. REASON FOR HEARINGS: PERCEIVED NEED TO STRENGTHEN AND IMPROVE ENFORCEMENT TOOLS

We understand that the primary reason for this hearing is a growing perception that at least some of our laws dealing with false or fraudulent claims, such as the civil False Claims Act (31 U.S.C. 3729 et seq.), are in need of retooling and strengthening. For some time there have been periodic proposals to establish a Government-wide administrative mechanism, outside the judicial system, for dealing with allegedly fraudulent claims involving smaller sums, especially in the various Government-administered loan and benefit programs. The proponents of this Program Fraud legislation argue that in many cases the amounts involved cannot justify the allocation of valuable prosecutorial resources; therefore, many of these smaller cases go unprosecuted.

Together, these perceptions and opinions have produced a number of bills now pending before this Subcommittee. 2/ Others, with similar or identical goals, are pending in the Senate. 3/

III. ESSENCE OF PROPOSALS: INCREASE PENALTIES, EASE THE PROSECUTOR'S BURDEN AND REACH UNPROSECUTED FRAUDS

Among other things, the pending bills would significantly increase monetary penalties under the existing civil False Claims Act, overturn or dilute court-established standards of knowledge and proof under this statute, substantially enhance the Government's investigatory tools and powers in the false claims area, and provide certain greater access to grand jury materials, presumably to aid in civil fraud prosecutions. Most significantly, the Program Fraud proposals would establish an additional government-wide administrative bureaucracy for dealing with alleged false claims involving less than $100,000, primarily on the theory that many such frauds currently are going unprosecuted. 4/ In theory, the cumulative effect -- and apparent primary goal -- of all these proposals would be to make the Government's task of detecting and punishing a fraudulent claim, at least in the civil context, an easier one.

IV. AIA'S GENERAL PERSPECTIVES AND SPECIFIC CONCERNS

There is nothing inherently wrong with such a goal. But AIA believes that this aim must be balanced with the need to maintain fundamental principles of due process in the standards and procedures employed by the Government in enforcing the laws.

The Association recognizes that an administrative process may be the needed mechanism for handling large numbers of smaller fraud cases. However, the Association strongly believes that legislators should proceed with deliberate caution when it comes to removing the inherent protections afforded by the judicial system. AIA is concerned that, in a number of fundamental respects, the proposals disrupt this essential equilibrium and would lead to erosion of fundamental due process rights. This concern is greatest when it comes to removing the inherent protections afforded by the judicial process and substituting an administrative mechanism where the allegedly wronged agency serves as investigator, prosecutor, judge and initial appellate authority. 5/ The dangers inherent in such an approach are obvious.

The Association has closely followed the development of the Program Fraud bills in the Congress. In addition to AIA's overall concern with the creation of a new "civil fraud" bureaucracy, AIA's deepest concerns with these proposals lie in the following key areas:

A. The standard of intent or knowledge necessary to establish civil liability under a judicial or administrative framework for prosecuting false or fraudulent claims.

B. The Government's burden of proof in establishing that a claim is false or fraudulent under either such framework.

C. The availability of testimonial subpoena power to Government officials investigating allegations of false or fraudulent claims, especially in an administrative context where the investigatory target may have only limited access to the nature of the charges and evidence against him.

D. The lack of any requirement for active, truly independent, prosecutorial review and approval before proceeding to try false claims allegations in an administrative forum.

A. The Standard of Intent or Knowledge

Probably no other element of the Program Fraud, and now the civil False Claims Act, proposals has been the subject of greater discussion and interpretation than the standard of intent or knowledge required to establish liability. Indeed, in AIA's view, this element of these legislative proposals is probably the most critical and potentially far-reaching in impact.

AIA believes that a person should not be held liable for a false or fraudulent claim (or statement) unless he acts with conscious culpability. The person must have acted (1) with actual knowledge that the claim was false or (2) with "reckless disregard" for the falsity of that claim. No lesser standard should be approved, especially for application in a broadly employed administrative apparatus.

Reckless disregard under such a standard would cover the person who consciously and deliberately shields himself from information necessary to assess the falsity of a claim. This is the "ostrich" or "head-in-the-sand" scenario which should not be permitted as a convenient avoidance of liability. Reckless disregard also could encompass the person who, faced with a significant and clear risk of falsity (i.e., a signal that something is amiss), deliberately proceeds in conscious disregard of that risk. 6/ The concept of "reckless disregard" is not a new one in the context of Program Fraud proposals. Previous versions of such bills have included this term. 7/

AIA believes that it would be unreasonable to apply any broader standard, such as one that generally would penalize negligence or, more specifically, the failure to conduct an investigation that a "reasonable and prudent man" should or would conduct. Such a standard drifts far afield of traditional common law concepts of fraud. Moreover, as compared with existing court precedent, it would appear to impose a most lenient and broadest interpretation of the civil False Claims Act. 8/

Furthermore, application of such an inherently subjective definition would have decidedly practical implications. In this day and age it is reasonable for a businessman to rely on the actions of responsible employees who assist in the preparation of claims against the Government. Adoption of some form of negligence standard, wrapped in a duty to investigate, could make it no longer reasonable for that businessman to rely at all on his employees, even his most trusted ones.

Negligence, mistake, inadvertence, indeed, honest disputes with the Government, these are not the stuff on which judgments of fraud or falsity should be based--whether it be in a court or in an administrative proceeding. The standard of intent or knowledge adopted by the Subcommittee should very clearly and precisely exclude such unwitting conduct from its scope.

B. The Government's Burden of Proof In Establishing That A Claim Is False or Fraudulent

The various proposals before the Subcommittee would permit the Government to establish liability for a false or fraudulent claim--whether in a court or administrative proceeding--based merely on a preponderance of the evidence. This is a clear dilution of the Government's burden of proof as currently required. 9/

AIA has previously noted that the proposals pending before the Subcommittee would significantly increase the substantial monetary penalties currently applied to false or fraudulent claims. The Association believes that the damage provisions of the civil False Claims Act--and its administrative progeny, the Program Fraud bill--would fall somewhere between the criminal penalty available to the Government under the criminal False Claims Act and a compensatory recovery under a contract or common law. Currently, under the civil False Claims Act, the Government can recover double damages, plus penalties and costs of the civil action. Under the pending proposals, the penalty amounts would be increased anywhere from 2 and a half to 5 times the present level. In AIA's view, it is unprecendented and unfair to permit what amounts to punitive damages without a higher level of proof than that required for compensatory damages. Similar penalty levels are included in the pending Program Fraud proposals.

In AIA's view, these changes, when coupled with a lightening of the burden of proof, would permit the Government in effect to obtain what amounts to punitive damages, without a higher level of proof than that required for compensatory damages. The fact is that the clear and convincing standard of proof is frequently applied in cases involving fraud allegations or severe administrative penalties. 10/ For all these reasons, AIA believes that the Government's burden of proof should be retained at the "clear and convincing evidence" level under both the civil False Claims Act and any Program Fraud bill.

C. The Availability of Testimonial Subpoena Power To Government Investigating Officials

This issue arises in two contexts in the proposals now pending before the Subcommittee. In both cases, AIA's paramount concern is the need for such a powerful investigatory tool, the potential for abuse and the protections afforded those who might be the targets of such subpoenas.

The first context in which this issue arises is the engrafting of a civil investigative demand mechanism for potential court proceedings brought under the civil False Claims Act. Authority for government lawyers to issue civil investigative demands ("CIDs") already exists in one area of the U.S. code--antitrust law. 11/ The Subcommittee should carefully assess whether the factors which justified the grant of CID authority in that context are equally applicable here. In any case, a CID mechanism, with or without testimonial subpoena power, applied in the civil False Claims Act arena should include each and every protective mechanism afforded under the existing antitrust law and its interpretive cases. Finally, the Subcommittee should closely examine the extent to which testimony taken in this pre-judicial context should be automatically shared with other government investigators, especially those seeking to impose penalties through administrative adjudications.

This second context in which the testimonial subpoena power issue arises is the grant of such authority directly to investigators preparing for potential administrative proceedings under a Program Fraud statute. AIA is unalterably opposed to such a grant, even if it is restricted to the Inspectors General themselves. There is little or no evidence to show that such investigators truly need such independent subpoena authority to do their jobs successfully.

Moreover, without clear and precise limits on the use of such subpoenas (and the data gathered thereunder), AIA believes that there is a potential for misuse in an administrative environment, where there would be decidedly less protections than afforded under the CID structure. For example, based on the pending proposals, in the CID context the target of such a subpoena would be told up front of the allegations of conduct violating the law and would be able to seek a court ruling quashing the demand. In addition, information collected by a CID would be specifically exempt from disclosure under the Freedom of Information Act (5 U.S.C. 552). Finally, subpoenaed testimony under such a CID must be "concerning documentary material or information." To AIA's knowledge, none of these fundamental protections has been included in any of the proposals for testimonial subpoena power in the Program Fraud context.

The import of granting testimonial subpoena power to the Government's investigators is even more significant in light of the limited discovery rights that would be available to the target of such a subpoena. Under most of the Program Fraud proposals, the person would have no right to obtain the notice sent to the Attorney General as the basis for the administrative case. In fact, unlike the CID mechanism, when subpoened to testify by an investigator, the person would not have to be given any specific information on the nature of the allegations against him. The accused's discovery rights at the hearing stage generally would be limited and left to the discretion of the hearing examiner. There are no minimum discovery rights provided to the accused enabling adequate trial preparation.

The Administration wisely has been (and remains) opposed to granting testimonial subpoena power to administrative investigating officials under a Program Fraud bill. In a letter dated November 4, 1985, concerning S. 1134, a Program Fraud proposal currently pending in the Senate, the Justice Department states unequivocally.

> "...[t]he Department of Justice and the Administration continue to object to...authorizing the Inspectors General to compel the testimony of witnesses. *We do not believe that there is a demonstrable justification for such extraordinary powers and we are seriously concerned with the potential this provision creates for interference with ongoing criminal investigations*. While we recognize that the proponents of S. 1134 have made efforts to accommodate our concerns on this issue, the proposed procedure for Department of Justice review of testimonial subpoenas is simply unworkable." (emphasis added). 12/

AIA wholeheartedly agrees with that stand and, to date, is aware of no change in this Administration position. The Inspectors General have been quite successful in their efforts to ferret out fraudulent or false claims without this unprecedented power, which is not even possessed by the Federal Bureau of Investigation. 13/ It should not be included in any Program Fraud bill approved by the Congress.

D. THE NEED FOR AN INDEPENDENT ASSESSMENT OF PROSECUTORIAL MERIT

The Program Fraud mechanisms before the Congress generally leave to the agency allegedly wronged the task of both investigating and referring to prosecution the offenses charged. In addition, employees of the wronged agency would try the cases and the agency head generally would sit as the initial appellate judge of a decision by one of his underlings.

AIA recognizes that the combination of such functions in a single agency is not without precedent in administrative law. Moreover, some of the Program Fraud bills have attempted to create a greater degree of independence within the agency, for hearing examiners trying these cases. And where there are agency administrative law judges, this may be less of a potential problem.

Still, in light of the stigma of the accusations and the severity of the penalties, at some point in the administrative process--prior to prosecution by the agency--an independent assessment should be made of the merits of the case. Most of the pending Program Fraud bills pay lip service to this suggestion by providing for "passive approval" by the Department of Justice of an administrative proceeding. In AIA's view, this is not enough. At a minimum, there should be a requirement for "active" approval or disapproval by the Department of Justice. 14/ That is the only way to ensure that the merits of these cases are being evaluated closely by the Attorney General. AIA notes that the ABA's Section of Public Contract Law, among others, has taken a similarly strong position on this matter. 15/ The Association believes that the Subcommittee should give this issue the highest consideration.

E. Additional AIA Concerns

In addition to these four major items, AIA wants to provide comments on several other areas of concern about the proposals pending before the Subcommittee.

1. Administrative Liability and The Standard of Appellate Review -- The Program Fraud proposals before the Subcommittee would adopt a relatively narrow standard for appellate court review of the hearing examiner's factual findings. Generally, these findings are limited to review for support by substantial evidence in the record. On the other hand, the Administrative Procedure Act ("APA") (5 U.S.C. 706) allows an appellate court to set aside "agency action, findings and conclusions found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." The Contract Disputes Act (41 U.S.C. 609) offers another, more comprehensive, standard of appellate court review. AIA sees no reason why Program Fraud administrative decisions, with their potential for substantial penalties and as-

sessments, should be subjected to any lesser standard of appellate review. Any Program Fraud bill approved by the Subcommittee should include a standard at least equal to that in the APA.

2. Qui Tam Suits -- There are proposals in Congress, including some in H.R. 3317 now pending before the Subcommittee, to modify the qui tam provisions of the civil False Claims Act. 16/ Generally, the apparent intent of these revisions would be to provide a greater incentive for use of this existing statutory mechanism.

The concept of private attorneys general is hardly a new one, but AIA must offer a word of caution. The Subcommittee should take care to avoid adopting provisions that could stimulate a raft of flimsy actions which only serve to soak up the courts' (and the Government's) time without a genuine basis. If qui tam suits are to be encouraged, there should be a mechanism for tempering the overenthusiastic citizen prosecutor, perhaps by requiring that he pay the defendants' costs of fending off any qui tam suit deemed by the court to be without a substantial basis. The provisions of the Equal Access To Justice Act afforded an analogous remedy in the case of certain government legal actions. 17/

3. Access To Grand Jury Materials -- Although these proposals do not amend the civil False Claims Act, they apparently have been put forward in the interest of enhancing the government's ability to prosecute fraud in the civil forum. Traditionally, access to grand jury materials outside the criminal prosecutor's office and the court has been limited to a select group of individuals. The law and courts have been reluctant to grant expanded access to such sensitive materials without specified showings. 18/ AIA would urge the Subcommittee to proceed with special caution when it comes to the proposals to expand such access beyond traditional borders. Learned members of the bar have reportedly expressed deep concerns about similar initiatives pending in the other House. 19/ AIA believes that those concerns are justified.

V. CONCLUSION: A FINAL PERSPECTIVE

There is another aspect to AIA's concerns which warrants the Subcommittee's consideration. It is different in the sense in that it is not couched in legal terminology. Rather, it is a simple and direct appeal to the fundamental concepts of fair play and even-handedness. While seemingly mundame, these concepts are the very underpinings of a process in which the Government, stepping down from its sovereign throne, enters into the free market place to transact the business of doing business with the private sector. This is an arena in which those engaged have elected consciously and voluntarily to provide the services and material essential to our national defense.

Admittedly, this election is not totally altruistic. Industry contemplates a fair and reasonable return on its investment of human and material resources. Without such a return, it could not compete to attract the capital and investment required to accumulate the facilities, plant and personnel essential to performance. We believe that this arrangement has served both industry and this Government well. Both have prospered and we look forward to the continuance of this relationship in the future. However, if in the conduct of business with the Government, industry is obliged to assume unconscionable risk or is burdened through law or intimidation with penalties and punishments disproportionate to any offense or intended wrongdoing, industry will be discouraged from participating in the arena of defense contracting. Given the complexity of that business, the volume of transactions, the potential for innocent error, the uncertainty and vagarity of so many of the rules, the risks to industry become unbearable and prohibitive. This is not a threat, but an appeal to reason.

Congress must and should discern the meaningful distinction between the risk to an individual submitting but one claim to the Government dealing with but one and, in the terms of reference to that individual, significant matter and with a defense contractor who, within the course of a single contract, asserts literally hundreds of thousands if not millions of transactions...each one of which can constitute a distinct claim. When aggregated, the potential for penalty is unbounded--far greater than the penalty would be under like criminal and civil statutes in which the accused is assured of all the normal safeguards of due process. And quite frankly, the statistical probability for getting caught up in an accusation of civil or Program Fraud is almost inevitable.

I cannot tell you how disconcerting and disruptive to a defense contractor is any such charge. Not only does it taint the nature of our relationship with the customer and do uncalculable damage to our corporate image, but it generates a host of activity totally unrelated to accomplishment of the final objective--contract performance--the cost of which is required to be absorbed by the contractor even when innocent of the charge.

Should you think I exaggerate the magnitude of the problem, let me note the recently accomplished report of the OSD Task Force Conference Report on Cost Principles dated 8 November 1985.

It was written by 20 Defense "costing experts" examining existing regulations--of which there are 48 total. It found 38 of those 48 defective in one or more significant ways (specificity, clarity, practicality, or effectivity) and made more than 71 distinct recommendations for DAR Council action.

We are not dealing with a precise science but with general principles subject to individual interpretation colored by perception--interpretations over which even specialists and experts can and do disagree in the majority of cases. While there is room for improvement, and I believe some progress can and will be made, there will always be significant areas of "gray". I exhort this Subcommittee to ponder the good sense fairness of reserving the opportunity to deal with these gray areas in a non-adversarial forum through discussion and negotiation at the level of the contracting officer and auditor, as has been our past practice, rather than taint them with the aura of administrative actions prescribed by a bureaucratic tribunal dictating severe penalties, stigmatizing industry, and making no distinction between willful misconduct and honest errors of judgment.

That concludes AIA's prepared statement. Again, the Association has appreciated this chance to share it opinions with you. AIA certainly stands ready to formally or informally assist the Subcommittee as it further considers the proposals. I am now prepared to answer any questions that you might have. Thank you for your attention.

FOOTNOTES

1/ Letter From Thomas E. Abernathy, Chairman, Section of Public Contract Law, American Bar Association, To Senator William V. Roth Jr., July 20, 1984, at 1; *see Hearing Before Subcomm. on Oversight of Govt. Mgmt. of Senate Comm. on Governmental Affairs on S. 1134*, (June 18, 1985), at 88 (Testimony of Karen Hastie Williams) (hereinafter "*Senate Hearings*, at _____").

2/ *See*, *e.g.*, H.R. 2264, H.R. 3317, H.R. 3334, H.R. 3335 (all 99th Congress, 1st Session).

3/ *See*, *e.g.*, S. 1134, S. 1562, S. 1673 (all 99th Cong., 1st Session).

4/ There has been much discussion of the need for an administrative mechanism being driven by the Justice Department's lack of resources. See *S*. *Rep*. *No*. 212, 99th Cong., 1st Sess., at 5, 38, 39 (hereinafter "*Senate Report*, at ____"). No suggestion has been made that some of the prosecutorial burden might be assumed by the defrauded agencies' own lawyers. *See Federal Crop Insurance Corporation v. Hester,* 765 F.2d 723 (8th Cir. 1985) (FCIC apparently successfully brought its own suit on false claims of $25,639.90).

Setting up, staffing and running a government-wide administrative program presumably also would consume substantial Governmental resources.

5/ Other members of Congress have voiced analogous concerns. *See Senate Report*, at 68-69 (Minority Views of Senator Cochran); 132 Cong Rec. 5299-300 (daily ed. January 21, 1986) (Remarks of Senator Hawkins).

6/ In the *Senate Hearings*, a key Administration witness agreed that beyond actual knowledge, these were the types of conduct that should be covered by the term "reason to know" that a claim (or statement) was false. *See Senate Hearings* at 15 (Testimony of Acting Assistant Attorney General Richard K. Willard).

7/ *See*, *e.g.*, S. 1780, 97th Cong., 2d Sess. (1981).

8/ Several Federal Circuits require a showing of specific intent to defraud under the civil False Claims Act. *See*, *e.g.*, *United States* v *Aerodex*, 469 F.2d 1003, 1007 (5th Cir. 1972); *United States* v *Mead*, 426 F.2d 118, 122 (9th Cir. 1970). Others require a showing of actual knowledge of falsity, and nothing less. *See*, *e.g.*, *United States* v *Hughes*, 585 F.2d 284, 286-287 (7th Cir. 1978); *United States* v *Ekelman & Associates*, 532 F.2d 545, 548 (6th Cir. 1976). Even the decision in *United States* v *Cooperative Grain and*

Supply Co., 476 F.2d 47 (8th Cir. 1973), off-cited in support of a negligence-type standard, found that the defendants' conduct was "extremely careless and foolish," noting that it "approaches fraud, an intentional misrepresentation" since "the intent to deceive of a fraudulent misrepresentation may include a reckless disregard for the truth or falsity of a belief." 476 F.2d at 60.

9/ *See*, *e.g.*, *United States* v *Ekelman & Associates*, *supra*, 532 F.2d at 548 (6th Cir. 1976); *United States* v *Foster Wheeler Corporation*, 447 F.2d 100, 101 (2d Cir. 1971); *United States* v *Mead*, *supra*, 426 F.2d at 123 (9th Cir. 1970); *see also* *Hageny* V *United States*, 570 F.2d 924 (Ct. Cl. 1978).

10/ *See*, *e.g.*, *Woodby v INS,* 385 U.S. 276, 285-286(1966) (deportation). *Sea Island Broadcasting Corp. of S.C. v FCC*, 627 F.2d 240, 244 (D.C. Cir.), *cert. denied*, 449 U.S. 834 (1980) (revocation of radio license); *Loftin and Woodward, Inc. v United States*,, 577 F.2d 1206, 1236-37 (5th Cir. 1978) (income tax fraud).

11/ *See* 15 U.S.C. 1311-1314 (antitrust civil process).

12/ *Senate Report* at 37 (Letter from Acting Assistant Attorney General Phillip P. Brady).

13/ See Senate Hearings at 28 (Testimony of Acting Assistant Attorney General Richard K. Willard).

14/ Even under the present system, the Justice Department was apparently able to make some determinations that many of these cases "had no prosecutive merit." Senate Report at 35 (Letter of Milton J. Socolar).

15/ See Senate Hearings, at 99-100 (Statement of Karen Hastie Williams).

16/ See 31 U.S.C. 3730.

17/ See, e.g., former 5 U.S.C. 504.

18/ See generally Federal Rule of Criminal Procedure 6(e); U.S. v Sells Engineering, Inc., 463 U.S. 418 (1983).

19/ Federal Contracts Report, Vol. 44, No. 21, 948-949 (November 25, 1985).

Mr. **Glickman**. Thank you both. That was an excellent statement as well.

I would just comment, Mr. Menaker, on page 17, when you talk about the review standard—the appellate review standard——

Mr. **Menaker**. Yes, sir.

Mr. **Glickman** [continuing]. I think the standard that you cite there is the standard for review of rulemaking decisions. It is my understanding from staff that the standard for on-the-record adjudicative review is the basic substantial evidence rule, which I think is a—at least that is what I have been advised—which is a more complete review, and the burden is not quite as great as it would be under the arbitray andcapricious standard for rulemaking.

Mr. **Menaker**. I thank you for pointing that out.

Mr. **Glickman**. I just make that point for you, so it is not quite as bad as you thought it was, is what I was trying to say there.

I would like to go to the issue that you both talk to—it has to do with the state of mind involved in a false claim. I guess the question here is: Actual knowledge—I think all of us could agree, that if, or either of you, willfully, intentionally as either any lay person would describe that, and with malice of forethought, try to go in and defraud the Government by doctoring up a claim, that would be a satisfactory definition for the purposes of the False Claims Act.

The question would be, is it has to do with constructive knowledge, or the kind of should-have-known, but didn't know, but not necessarily negligence either. We are talking about a middle standard that, as an example, an individual says, "Don't tell me what you are doing, I tell my staff people, but if you have to play around with those claims, fine, but I don't want to know anything specific about it."

How do you feel about a should-have-known standard that is not a negligence standard, but some kind of standard which says that if you acted in reckless disregard of the truth but you might not have had actual in front of you type of knowledge; should that not also be covered under the False Claims Act?

Mr. **Cross**. I think something like reckless disregard certainly is fine. I think the question of should-have-known is really open to what does that mean. In the case of my company, and I am certain in the case of the other companies represented, that the number of offices you might have and the number of different projects ongoing are quite great. I mean, we are a company of less than 200 people. We have five offices in Maryland, offices in Pennsylvania, Hawaii, and three overseas. And trying to, just from a company of our size, keep track of what might be going on that might lead to a claim at some point down the road is a burden of impossibility if it is not very tight in terms of constructive knowledge or something of that sort.

Mr. **Glickman**. You would want a definitional standard of should-have-known that would be clear enough and severe enough so that it would not lead to an unnecessarily vague interpretation that migmt push you down toward the negligence standard?

Mr. **Cross**. That is correct.

Mr. **Glickman**. OK. Mr. Menaker.

Mr. MENAKER. Yes, sir. Certainly actual knowledge and reckless disregard would be a standard that we would advocate very strongly. When you asked about should-have-known, it causes me even greater distress. In our corporation, for example, we have 67,000 employees. They are located all over the country, very actively engaged in the Government contracting process. When you combine the work that they do, particularly in the administrative area, with the lack of precision that does exist with regard to understanding a number of these regulations and interpreting them, it would worry me, and I think it would worry a lot of people in our organiztion to say should have known.

Mr. GLICKMAN. I think that you make a good point there and I think that that is something we are going to have to deal with. I am sensitive to this particular situation.

I don't think either of you addressed the issue of raising the damage amount from $2,000—maybe you did, I don't recall—to $10,000. I wonder if either of you have any—on a per claim basis—do you have any feeling about that? Mr. Menaker, or Mr. Cross, either one of you?

Mr. MENAKER. I don't have a view on that. Certainly $2,000 is a minimal amount. If you are looking at it from a deterrent effect, a higher amount would have a more deterrent effect.

Mr. CROSS. I think from our viewpoint it is the procedural issues that concern us, not the amount of thespecific damages.

Mr. GLICKMAN. I was going to ask you some questions about the due process points but I think you have covered them in your statement, both of you, but particularly Mr. Menaker, pretty carefully. We will work with you on this.

It is my intention to move ahead legislatively. The Senate is moving ahead and we will also, but we will do so reasonably, so we will keep you informed of what is going on.

Mr. CROSS. We appreciate that, thank you.

Mr. GLICKMAN. Mr. Kindness.

Mr. KINDNESS. Thank you, Mr. Chairman. I have no further questions.

Mr. GLICKMAN. OK.

Mr. CROSS. I might say, from my viewpoint, Mr. Kindness, we appreciate your sensitivity in your earlier questioning of some of the witnesses on the small business concerns, because it is a real issue, as I pointed out in our statement, about how some of these features would affect small businesses, and how they could possibly defend themselves in some of these cases. Thank you.

Mr. KINDNESS. Mr. Chairman, if I might just ask one question.

Mr. GLICKMAN. Sure.

Mr. KINDNESS. I envision cases that we are talking about under program fraud bill in particular, perhaps, involving a number of incidents—for example, timecards, allocable to one contractor or another in which, as I understand it, we would be talking about separate counts, so to speak, that might be quite numerous in total, but would come under the program fraud, the administrative type of approach. And if we were talking about a thousand or something like that, which could conceivably and apparently has occurred—where they were misallocated as to hours, or misallocated as to one contract or another—you could have a very substantial amount of potential penalties involved in a somewhat unified proceeding.

In such a case, of course, I would imagine that a $2,000 maximum, or a $5,000 maximum, would make it at least a 100-percent difference in what is involved. So, I would certainly urge there be consideration by the subcommittee of how such cases ought to be dealt with, whether they should be joined in one action—as presumably they should. But when they are joined, should they come under the administrative process or the normal judicial process. That one is a question that is left open here, I think.

I would also urge, Mr. Chairman, that the record remain open on these hearings for some time here—10 days or so, I think. I would like to ask if Mr. Menaker could provide for the record, as he indicated, a copy of the report referred to in his testimony at about the last page or so.

Mr. **Menaker**. Yes, sir, I will be delighted to do that.

Mr. **Glickman**. We will keep the record open for an additional 10 days if anybody wants to supply additional material for the record.

Mr. **Kindness**. Thank you, Mr. Chairman.

Mr. **Glickman**. Thank you. I appreciate you both testifying.

Mr. **Menaker**. Thank you.

Mr. **Cross**. Thank you.

Mr. **Glickman**. The last witness is Mr. Howard Cox, Deputy Assistant Inspector General, Department of Defense.

Mr. Cox, we appreciate your cooperating with us and with the previous panel on time. Sorry it has taken so long but it is a complicated subject.

TESTIMONY OF HOWARD W. COX, DEPUTY ASSISTANT INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

Mr. **Cox**. Frankly, sir, I look forward to any way we can demonstrate that the Defense Department and industry can get along, and if this will perhaps help in that regard we are glad to do it.

Mr. **Glickman**. Perhaps, as Mao Tse-tung said, "A long march starts with a single step." Maybe it has started today.

Mr. **Cox**. Mr. Chairman, with your permission, I would like to insert my prepared statement for the record and summarize it.

Mr. **Glickman**. Your entire statement will appear in the record and you may summarize if you wish.

Mr. **Cox**. Thank you, sir.

If I may commence my remarks with just an observation. It is interesting to notice perhaps how far we have come since the GAO report, that you referred to in your opening statement, was originally issued. At that time, I was a member of the Senate Governmental Affairs Committee staff and we considered putting in a program fraud bill. We had representatives of an aerospace company who appeared before our committee at that time and represented in 1981 that there was no such thing as procurement fraud in the Department of Defense.

I think the last 5 years have proven that the accuracy of that particular representation and hopefully the growing need for this particular kind of legislation—a program fraud bill.

I would like to thank you for the opportunity to appear on behalf of the Office of the Inspector General. I would like to make it clear that I am appearing on Mr. Sherick's behalf. He is unfortunately recuperating from an operation, otherwise he would appear, as he has in two previous Congresses, to support this particular piece of legislation. My comments represent only the views of the Office of the Inspector General and not of the administration. Mr. Willard's comments do that.

The Office of the Inspector General continues to support, as we have in the past, the establishment of an administrative penalty mechanism to address false claims and false statements submitted to DOD and the development and aggressive use of civil, administrative, and contractual remedies for fraud.

Traditionally, criminal prosecution has been treated as the primary weapon against fraud, and in many instances, as a precursor to any other actions taken. This has sometimes led to the practice that when a prosecution has been declined, there was no subsequent attempt to seek any other form of address from the offender.

We in the Inspector General's Office have, through a number of efforts, attempted to stop this practice, and improve the way we address fraud in our programs.

We have issued a DOD directive to establish a single authority in each military department to coordinate criminal, civil, administrative, and contractual remedies in fraud cases.

We have encouraged simultaneous civil and criminal referrals of fraud cases to the Department of Justice.

We have designed and presented a fraud training program for auditors, investigators, contracting officers, and the like, to heighten everyone's awareness as to where fraud exists in DOD programs.

Furthermore, we have increased efforts in providing fraud training to program officials, particularly personnel assigned to contracting responsibilities.

Each of these efforts has yielded improvements in the use of existing remedies for fraud. They have also clearly shown us that additional remedies are needed, which is why the Program Fraud Civil Penalties Act is so important.

Many of the cases referred to the Department of Justice for criminal prosecution are declined by DOJ for a variety of reasons. Many of these cases clearly involve false claims and false statements.

I believe the GAO report that you referred to identified that of all the fraud cases that were referred during the period they looked at, two-thirds were declined by the Department of Justice. However, GAO concluded that two-thirds of those cases were probably good cases, that is, that someone did indeed submit a false claim or false statement. But the Justice Department for a variety of reasons decided not to prosecute.

We certainly can't dictate the priorities to the Department of Justice from the Department of Defense. But ultimately, we in the Department of Defense are responsible for the integrity of our own programs. We believe that false representations, people lying to get benefits they are not entitled to from DOD, lying to get contracts, or contract payments that they are not entitled to in DOD, deserves an appropriate response by the Department of Defense.

There are several examples illustrating the need for civil penalty authority, particularly in the procurement area. I have included a number of examples in my prepared statement. I would just like to add an additional two.

We recently had a case in Michigan where a contractor on an Air Force base submitted a false claim for $900,000. The entire claim was false. He did not do any of the work equaling $900,000. We caught the claim before it was paid and, therefore, we did not pay the claim. We presented the case to the local U.S. attorney for criminal prosecution, who declined because the Government did not lose any money. Loss is one of the usual things that the Department of Justice legitimately uses as a criteria. But yet, we have an individual who boldly sought to get almost $1 million from the Department of Defense, and goes virtually without any kind of penalty because of the gap that exists in these particular areas.

We had another case in another U.S. attorney's office where an Air Force contractor had submitted $50,000, again, for a claim for work he had not at all performed. That case, too, was declined, again, based upon the dollar cutoff level and the fact that the claim was not paid. This, by the way, was with a U.S. attorney who just before that had prosecuted an individual for fishing with the wrong kind of worm in a Federal park.

I am not here to dictate his priorities. He has needs and concerns. But, again, the Department of Defense has needs and concerns. Clearly, the criminal justice process cannot respond to all of our needs and concerns, nor would we necessarily want it to. We think that this civil program will provide an adequate closing of this loophole that exists between those serious cases that we feel are serious and those that can't get adjudicated through the criminal justice process.

There are a number of particularly important aspects to H.R. 3335 on which I would like to comment. First, the bill includes false statements as well as false claims. This is extremely important in the area of contract fraud, especially when a contractor certifies a variety of different things that the Government requires a contractor to certify to as part of doing business.

For example, we require contractors to certify whether or not he is or is not a small business. Large businesses traditionally have sought to overcome or to circumvent this requirement by falsely certifying that they are small businesses, thereby cheating good-faith small businesses out of these kinds of contracts.

Traditionally, if the contract is successfully performed by the large business, we don't get a criminal prosecution because the U.S. attorney will say, the Government wasn't harmed. You wanted a clean building, you got a clean building even if he did lie to get the contract.

These are traditionally the kinds of cases we feel this particular penalty would be very, very valuable in.

These kinds of certifications are traditionally accepted by the Government in contracting, at face value, and are rarely questioned, because much of the Federal contracting process relies upon us relying on the integrity of the contractor.

We do business in DOD with more than 250,000 prime contractors and more than 400,000 subcontractors. To police the claims and certifications and deliveries that these people present, the Department has approximately 10,000 auditors and 8,000 inspectors and investigators. There is no way we could or we would even want to police on a regular basis that kind of performance, which is why we must rely upon the truthfulness and the integrity of those who are presenting us with goods, or presenting claims for money.

When we find that someone has misrepresented the facts, has done so knowingly, or in gross negligence, we feel that we should be allowed to respond with an appropriate penalty.

Second, we believe that the knowledge standard provided for here—"knows or has reason to know"—is an appropriate one for a finding of liability under the act. We favor this general intent provision over a requirement to establish specific intent to defraud in order to make a finding of liability. This general intent standard has been generally accepted in the majority of civil cases that have been litigated under the False Claims Act and in other administrative matters.

One aspect of tremendous importance which is found in S. 1134, Senator Cohen's bill, but is absent from the House proposal, concerns the availability of testimonial subpoenas to the investigating official—in our case the DOD inspector general.

The need for such authority is critical to our successfully uncovering false claims and false statement schemes. Proof of knowledge, be it constructive or actual, is particularly difficult in fraud cases, where conspiracies often exist and form the basis for the undertaking of the deception.

We have no way to pierce these kinds of conspiracies unless we can get those who are responsible to come before us and talk to us.

Many DOD contractors currently are aggressively seeking to limit of our ability to speak with corporate personnel, which makes the need for this authority even more critical. And, contrary to assertions made by others who are interested in not having this bill become law, there is ample precedent for the testimonial administrative subpoenas by Federal agencies.

As the Senate Governmental Affairs Committee report points out, there are over 60 statutes which grant testimonial subpoena authority to administrative adjudicatory bodies as well as investigatory bodies.

I should also point out that the inspector general community has had documentary subpoena power since 1978, and there is not a single documented instance where that subpoena authority has been abused. I think that there are adequate performance records to show that the investigators who would be using this authority are trained professionals. For those few instances where an abuse might be present—and, again, it is speculative, as I said, there has been no identified abuse—any U.S. district court certainly has the authority to require the inspector general to respond to a motion to quash or require the inspector general to go to court to demonstrate the legitimacy of an investigation, the fact that the testimony is reasonably related to that legitimate investigation and that it would not be burdensome upon the individual to provide that kind of testimony. It is just standard judicial review of administrative subpoenas.

We also believe that a potential penalty of $10,000 is a more useful deterrent than the $5,000 penalty currently provided in H.R. 3335. It should be noted that Congress, in passing the Defense Authorization Act, recently allowed DOD to impose an administrative penalty of up to $20,000 when certain DOD employees fail to report employment offers by DOD contractors. Certainly, the submission of a false claim or a false statement by contractors to obtain benefits and taxpayer funds deserves no less than that kind of a potential penalty.

The provisions of the act dealing with notice, hearings and determinations of liability will serve to protect the right to a fair trial and reasonable hearing for any person alleged to be liable, and provide adequate due process for all parties concerned. Indeed, it may be argued that the utility of the bill might be substantially undermined if it costs the Government $50,000 in administrative costs in order to impose a $5,000 penalty.

It should be noted that the recently enacted Defense Procurement Improvement Act allows DOD to impose far greater administrative penalties for certain kinds of contract fraud in a more expeditious and less costly manner.

Finally, as regards the various proposals to amend the False Claims Act, I will simply outline certain certain improvements which the inspector general's office believes are essential.

First, the act, we believe, should be clarified to state that a finding of liability should be based upon a preponderance of the evidence standard, demonstrating that the accused knew or should have known of the falsity of the submission. The preponderance of the evidence standard has been adopted by the majority of Federal circuits which have examined the False Claims Act. We feel that the act should be amended to make thisthe standard across the board.

Second, we believe that the penalty should be raised from $2,000 to $10,000, and that the Government should be able to recover treble, rather than double damages. Again, under the Defense Procurement Improvement Act, a contractor who submits a false claim to DOD on a DOD contract is liable for treble damages under the False Claims Act.

It doesn't make any sense whatsoever to hold DOD out as the only organization that can take benefit of this treble damage provision. Fraud in HHS or the Department of Agriculture is just as important there, and they, too, should enjoy the benefits that we have with regards to treble damages.

In conclusion, we believe that the Program Fraud bill will provide an important weapon to the Department of Defense, as similar provisions have already been of great assistance to the Department of Health and Human Services in their campaign against medical fraud. It is ironic that HHS has had this authority to combat fraud in health programs, but that DOD does not have this authority to deal with fraud on Government contracts.

We are willing to work with Congress and look forward to providing any assistance that we can.

If I may, sir, just one final observation. There was some discussion earlier, as the impact of these kinds of statutes upon the application of the Contract Disputes Act, and would fraud on these particular areas have any adverse impact upon the orderly disputes resolution process under the Contract Disputes Act.

In our opinion, sir, it would not. Section 6 of the Contract Disputes Act and the Boards of Contract Appeals decisions interpreting section 6 clearly hold that fraud takes the matter out of the contract disputes process. If fraud is indeed involved, the disputes process has no application to the resolution of the issue. That is always appropriate outside of the contract disputes process.

We feel that this act is consistent with that.

When that act was considered in 1978 and some antifraud provisions placed in it act, a number of contractors represented that this would somehow allow contracting officers to raise the specter of fraud, to cloud contract negotiations, and that contract negotiations would come to a standstill if contracting officials were allowed us to raise fraud on an easy basis.

I think the documented history of the Contract Disputes Act since 1978 has shown such that horror, stories have never taken place, that fraud is only alleged in contract disputes negotiations when it is reasonable to do so, and when it is a proper matter for consideration by the Department of Justice and those investigative organizations that have the responsibility for looking at fraud. Clearly, a contracting officer has an obligation to be sensitive to fraud but he is not in the job of raising that as a defense or arguing it in the context of a contractual dispute.

[The statement of Mr. Cox follows:]

STATEMENT OF HOWARD W. COX, DEPUTY ASSISTANT INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

MR CHAIRMAN AND MEMBERS OF THE COMMITTEE

I would like to thank you for this opportunity to appear on behalf of the Office of the Inspector General of the Department of Defense and provide our comments on an important legislative matter, the proposed Program Fraud Civil Penalties Act, H.R. 3335. My comments represent only the views of the Office of the Inspector General, DoD, since the Administration's views are being presented to this Committee by the Department of Justice. This legislation will permit the Inspectors General to more effectively combat fraud, waste and abuse, and further implement the Administrations's initiatives in this area.

The Office of the Inspector General continues to support, as we have in the past two Congresses, the establishment of an administrative penalty mechanism to address false claims and false statements submitted to the Department of Defense and the development and aggressive use of civil, administrative and contractual remedies for fraud in conjunction with or in lieu of criminal prosecution. Traditionally, criminal prosecution has been treated as the primary weapon against fraud, and in many instances, as a precursor to any other action to be taken. This has sometimes led to the practice that when prosecution was declined, there was no subsequent attempt to seek administrative action to punish offenders, protect the Government and recover funds lost through fraud. This practice seemed to favor a one shot remedy, the criminal case, at the expense of any other related efforts.

We in the Inspector General's Office have, through a number of efforts, attempted to stop this practice, and improve the way we address fraud in our programs. Our efforts have been directed at achieving a coordinated approach to the investigation of fraud and the timely imposition of appropriate remedies for fraud available to us. We have taken several decisive steps in this area:

o We have issued a DoD Directive requiring the establishment of a single authority in each Military Department and Defense Agency to monitor fraud investigations and to coordinate criminal, civil, administrative and contractual remedies for fraud.

o We have encouraged simultaneous civil and criminal referrals of fraud cases to the Department of Justice.

o We have designed and presented a fraud training program for auditors, investigators and attorneys. This program familiarizes the participants with DoD contracting procedures, fraud investigative techniques, and relationships with the Department of Justice. Further, the program describes and stressess the need for coordinated application of administrative, civil, contractual, and criminal remedies for fraud. We have now presented this program 16 times with over 650 attendees.

o Increased efforts have been made in providing fraud awareness training to program officials, particularly personnel assigned to procurement responsibilities. During the last two years, the Inspector General and the military criminal investigative organizations have made over 6,800 fraud awareness presentations to over 255,000 attendees worldwide. These briefings stress improved recognition of potential fraud and more effective use of available remedies.

Each of these efforts has yielded improvement in the use of existing remedies for fraud. They have also clearly shown us that additional remedies are needed, which is why the Program Fraud Civil Penalties Act is so important. The Act offers a mechanism for an appropriate Government response to instances of fraud that occur but are not now addressed by the Government for a variety of reasons.

Many of the cases referred to the Department of Justice by DoD are declined for prosecution. Many of these cases clearly involve false claims and false statements. However, there are many reasons for not prosecuting these cases, including the evidentiary standard required to prove criminal violations, as well as other priorities to which the Department of Justice must devote its resources.

In making these resource allocation determinations, one criteria which is used is the dollar value of the loss to the Government in the case. Therefore, some United States Attorneys have established thresholds below which, absent special circumstances, fraud cases will generally not be accepted for prosecution. While the Department of Justice is clearly responsible for such prosecution decisions, the integrity of DoD programs must ultimately be the responsibility of the Department of Defense. Accordingly, we believe it is necessary to have a procedure within the Department of Defense to appropriately address those instances of fraud which the Department of Justice does not prosecute, but which clearly impact upon the integrity of our programs.

There are several examples illustrating the need for a civil penalty authority, particularly in the procurement area, which is a primary area of interest for the Inspector General. An administrative penalty mechanism could have been utilized in the following closed cases:

- Based on a GAO report, a Department of Justice and Naval Investigative Service investigation identified over $600,000 in fraudulent overpayments on a base maintenance contract in the Norfolk, Virginia, area. The contractor was found to have deliberately overbilled the Navy on numerous items. Because of evidentiary problems, a decision was made to seek criminal prosecution on only $25,000 in false claims. Subsequently, the Department of Justice determined that $25,000 was too small an amount to justify prosecution, and the case was declined for both criminal and civil action. An administrative penalty in this case could have facilitated a recovery of a substantial loss.

- A contractor engaged in a conspiracy with a DoD contracting officer in order to be awarded a DoD contract. The contracting officer falsified the need for a sole source procurement and, in collusion with the contractor, allowed the contractor to write the Government's sole source justification for the award. While prosecution was declined, in part because DoD discovered the scheme before the actual award of the contract and before there was a dollar loss to the Government, a conspiracy to defraud was clearly evident. Again, an administrative penalty would have been appropriate to punish this attack on the integrity of the procurement process.

- A medical supply company, in concert with a military doctor who was a part owner in the company, arranged to have a medical device purchased from the company on a sole source basis. Using his position as a senior medical advisor, the military doctor succeeded in recommending that this product be purchased DoD-wide on a sole source basis. The device was ultimately determined to be defective by the Food and Drug Administration, and possibly dangerous to use. It was withdrawn from DoD supply channels. The military doctor was convicted of related charges in Federal court and administratively reduced in rank at retirement. No criminal action was taken against the company or its officials. An administrative penalty against the company would have been appropriate in view of its collusion to defraud DoD.

- A painting contractor was required to use enamel and oil based paints and apply them with rollers and brushes to portions of structures exposed to the elements on a military installation. A quality assurance inspector caught the contractor applying latex water base paint with a sprayer. The contractor was stopped from performing the balance of the work, thereby limiting the amount of monetary loss to the Government. The Department of Justice declined prosecution of the case since we stopped the contractor early and prevented an extensive loss which would have given the case greater prosecutive merit. An administrative penalty would clearly have been appropriate here.

- A contractor was to erect and paint fences on a military installation. The contractor was discovered using Government equipment and property to do part of the work and then failing to comply with contract specifications in the rest of the work. The Department of Justice declined prosection in favor of administrative and contractual remedies, which could have included an administrative penalty hearing, had the Act been in effect at the time.

- In the CHAMPUS area, we have identified numerous cases where both claimants and medical service providers have submitted false claims and statements for treatments which were never provided, or for fraudulent overtreatment. In those cases where we have obtained prosections, our efforts to recover the funds have been successful. However, many CHAMPUS fraud cases are not prosecuted because, even though fraud has been proven, the loss to the Government is under $5,000 and criminal prosection in such cases is declined in favor of higher dollar cases. Given the fact that CHAMPUS is a program exceeding $1 billion annually with a substantial vulnerability to fraud, the imposition of an administrative penalty in such cases is a valuable tool to ensure recoveries of losses due to fraud.

- A contractor operated a parts store on 10 different military bases. He illegally inflated parts prices on each contract. While the total fraud amounted to over $50,000, no single base was defrauded for more than $6,000. Each case was presented to nine separate United States Attorneys, and was declined at each office because the dollar value was too low.

There are a number of particularly important aspects to H.R. 3335 on which we would like to comment. First, the bill includes false statements as well as false claims. This is extremely important in the contract fraud area, especially when a contractor falsely makes a variety of certifications, such as:

- a certification of small business size status;
- a certification of minority status;
- a certification regarding allowability of overhead costs;
- a certification regarding the completeness and accuracy of cost and pricing data.

These certificates are usually accepted at face value and are rarely questioned because much of the Federal contracting process relies upon the integrity of DoD contractors to accurately provide such information. When a false certification is discovered it undermines this essential relationship. These cases are rarely prosecuted, and unlike false claims, there is no civil statutory remedy for false statements. This bill will close this existing loophole, and allow DoD to penalize contractors who undermine the integrity of the contracting process.

Of equal importance is the need for a false statement provision for use in noncontractor cases. False certifications by individuals which permit them access to such programs as VA mortgage benefits, GI bill education participation and the like not only undermines the integrity of those programs, but results in increased program costs in direct payments as well as administration expense.

Secondly, we believe the knowledge standard provided for --"knows or has reason to know"-- is an appropriate one for a finding of liability under the Act. We favor this "general intent" provision over a requirement to establish specific intent to defraud in order to make a finding of liability. This general intent standard has general acceptability in civil cases litigated under the False Claims Act and in administrative matters.

In light of concerns raised by some interest groups that the legislation should make clear that mere mistakes or inadvertence are not actionable under this bill, we would endorse certain clarifying language, such as that contained in the reported version of S.1134, Senator Cohen's bill. That bill states clearly that, absent actual knowledge regarding falsity, only gross negligence from the accepted reasonable man duty to ensure claims or statements are accurate will cause liability to attach. This is a reasonable requirement and one which directly attacks the problems of certifiers "burying their heads" so as not to be informed of the basis of their submissions.

One aspect of tremendous importance which is found in S.1134 but is absent from the House proposal concerns the availability of testimonial subpoenas to the investigating official. The need for such authority is critical to our successfully uncovering false claims and false statement schemes. Proof of knowledge, be it constructive or actual, is particularly difficult in fraud cases, where conspiracies often form the basis for undertaking the deception. Documents alone don't always supply the link necessary to establish responsibility. Proof of knowledge is more often established by the testimony of coworkers, inspectors, accountants, subordinates, or others. Many DoD contractors are aggressively seeking to limit our ability to speak with such persons, which makes the need for this authority even more critical. And, contrary to assertions made by others who are interested in not having this bill become law, there is ample precedent for testimonial administrative subpoenas by Federal agencies. The Securities and Exchange Commission uses it as does the Antitrust Division of the Department of Justice, the Department of Housing and Urban Development, and the Federal Trade Commission. Congress itself has recognized the need for subpoenaing witnesses before its investigative committees when documents alone don't tell the whole story. Finally, it should be noted that Inspectors General have issued hundreds of documentary subpoenas under the Inspector General Act of 1978, and there is not a single reported instance of abuse of this power.

We also believe that a potential penalty of $10,000 is a more useful deterent than the $5,000 penalty provided in H.R. 3335. That figure, of course, is not a mandatory imposition but rather affords the trier of fact flexibility in setting an appropriate penalty in the most egregious case. It should be noted that Congress recently allowed DoD to impose an administrative penalty of up to $10,000 when certain DoD employees fail to report employment offers by contractors. Certainly, the submission of false claims and false statements by contractors to obtain benefits and taxpayer funds deserves no less a potential penalty.

The provisions of the Act dealing with notice, hearings and determinations of liability will serve to protect the right to a fair and reasonable hearing for any person alleged to be liable, and provide adequate due process for all parties concerned. Indeed it may be argued that the utility of the bill might be substantiately undermined if it costs the Government $50,000 in administrative costs in order to impose a $5,000 penalty. It should be noted that the recently enacted Defense Procurement Improvement Act allows DoD to impose far greater administrative penalties for certain kinds of contract fraud in a more expeditious and less costly fashion.

Finally, as regards the various proposals to amend the False Claims Act, I will simply outline certain improvements which the Inspector General's Office believes are essential.

First, the Act should be clarified to state that a finding of liability should be based on a preponderance of the evidence standard, demonstrating that the accused knew or should have known that the submission was false. To require a showing of specific knowledge is inappropriate in a noncriminal forum. Further, the inclusion of the better reasoned standards encompassing constructive knowledge for liability will end the confusion presently found in the circuit courts.

Second, we believe that the penalty should be raised from $2,000 to $10,000, and that the Government should be able to recover treble, rather than double damages. Under the Defense Procurement Improvement Act, a contractor who submits a false claim on a DoD contract is liable under the False Claims Act for treble damages, plus costs of the civil action. There is no legitimate reason to restrict this penalty only to false claims on DoD contracts.

In conclusion, we believe that the Program Fraud Bill will provide an important weapon to the Department of Defense, as similar provisions have already been of great assistance to the Department of Health and Human Services (HHS) in their campaign against fraud. It is ironic that HHS has had this authority to combat fraud in health programs, but that Department of Defense has not had this authority to deal with fraud on Defense contracts.

The Inspector General is eager to work with Congress in developing a mechanism which will provide due process and enable the Government to effectively combat fraud.

Mr. Chairman, this concludes my statement. I am prepared to address your questions.

Mr. Glickman. Thank you, Mr. Cox, for an excellent statement.

Mr. Kindness. I wonder if I might just ask one question to follow up on the last point.

Mr. Glickman. Sure.

Mr. Kindness. I would appreciate having your view on that matter of an interaction with the Contract Disputes Act. If I understood what you said correctly, there would be, since it is easier to prove fraud under the bills we are talking about here, it would be much easier to yank cases out from under the Contract Disputes Act procedure, would it not?

Mr. Cox. That would be correct, sir. With the Contract Disputes Act, and legislative history that I have seen, sir, we are dealing with the orderly resolution of normal business disputes. When we are talking about fraud, we are talking about one party intentionally deceiving the other party, or improperly deceiving the other party for the purpose of an unfair benefit. Clearly, that is not something that the normal disputes process should address.

Mr. Kindness. No, I agree there. If the question is raised—let's say that there was a false statement on the part of a contractor who had a claim pending, a false statement with respect to minority employment or equal opportunity, or some other of the many, many things that are supposed to be certified in a bid, that would, I take it, remove the case from a contract disputes procedure and it would become moot for the moment at least, I think.

Mr. Cox. I believe, sir, that under the decisions that have come up from the Armed Services Board of Contract Appeals, they will not remove the issue unless the fraud directly concerns the claim under discussion.

Mr. Kindness. Thank you. Thank you, Mr. Chairman.

Mr. Glickman. I think it is a good point, though. I don't think we want the whole series of cases being enforced here that don't relate to unlawfully taking more money from the Government in dollars than you are entitled to, so we may want to explore that in some way.

I just have one question. As I understand, the Department of Defense considers itself exempt from the Administrative Procedure Act and, therefore, does not utilize administrative law judges. How will the Department of Defense handle the hearing examiner so as to ensure fairness?

Mr. Cox. With regard to the application of the Administrative Procedures Act and these particular bills, both the Senate bill and the House bill require that the hearing officials meet certain standards with regards to independence, certain standards with regards to background training, and the like.

I believe the Department of Defense is more than willing to create or draw upon existing resources to find those kinds of people which exist within DOD.

The Senate bill requires certain requirements. It requires, for example, that people be in a grade level of GM-16 and the like.

In the Department of Defense, we have, for example, military judges who have been certified as judges and have served in criminal trials who have authority to adjudicate the death penalty. We should not be precluded from calling upon this corps of trained individuals to serve in this kind of a factfinding capacity. We would in no way want to delete—would dilute the necessary independence and requirements for training and background. But we would also ask that since we have certain individuals of special skills in DOD that we would like to be able to draw upon.

Mr. GLICKMAN. That raises another interesting question. The fraud that may be pursued under this bill is fraud within a military department. What you are saying is, we would have military personnel entering decisions affecting civilian people.

Mr. COX. That is correct, sir.

In that regard there may be some current concern that this somehow violates the Posse Comitatus Act or a variety of other things—some people talk about using military authorities to enforce civilian laws. It may be some concern that in the legislative history that point should be specifically addressed.

We in DOD would like to use those skilled people. We also understand the concerns of Congress and civilians at large of somehow subjecting civilians to, if you will, military authority.

The point is, sir, in contracts, for example, we have a number of military officers who are contracting officers. Clearly, a contracting officer's decision under the Contract Disputes Act has a direct impact upon the contractor. No one has ever alleged that a military contracting officer is incapable of making that kind of a decision. I would ask for similar considerations with regard to this.

Mr. GLICKMAN. In the Contracts Disputes Act, he is not in a position to enter a so-called judgment against the other party, is he, for damages?

Mr. COX. A contracting officer's final dsecision would be a final judgment unless the contractor sought to appeal it to the court of appeals or the Board of Contract Appeals.

Mr. GLICKMAN. But it doesn't have any penalty assessment, does it? I am just trying to determine if we have some sticking point that is far more serious than I had dreamt about.

Mr. COX. The only thing, sir, I can analogize it to both the Army and the Air Force, in the area of suspension and debarment, the ultimate suspension and debarment decision which has an impact at least as equal to this, by both the Army and the Air Force is made by a military officer. Their capability to do it has been specifically upheld by Federal circuit courts which have examined that particular issue.

Mr. GLICKMAN. OK. I don't know whether debarment, which relates to future actions or suspension, which relates to current actions, is the same in a penalty procedure in which you are trying to get something affirmatively from a civilian entity. I just think that is something we have to look into.

Mr. COX. We would request clear guidance on it.

Mr. GLICKMAN. I am concerned about it.

Mr. Kindness, do you have any additional questions?

Mr. KINDNESS. No, thank you, Mr. Chairman.

Mr. GLICKMAN. We thank you, Mr. Cox.

[The statement of Mr. Stark, and the combined statement of Senators Cohen, Roth, and Levin, follow:]

STATEMENT OF CONGRESSMAN FORTNEY H. (PETE) STARK
BEFORE
THE SUBCOMMITTEE ON ADMINISTRATIVE LAW AND GOVERNMENTAL RELATIONS
HOUSE JUDICIARY COMMITTEE
FEBRUARY 5, 1986

Mr. Chairman, Members of the Committee:

I appreciate the opportunity to testify. I will be very brief.

I urge the Subcommittee to develop more effective incentives for government and contractor employees to "blow the whistle" on fraud against the Government. I've introduced a bill, HR 1975, which I believe can help.

1863 FALSE CLAIMS AND QUI TAM ACT

This bill takes the 1863 false claim and qui tam idea and tries to restore it to life through amendments that override a number of judicial decisions that have made the ancient qui tam concept toothless.

In short summary, the false claims/qui tam concept provides that a citizen can bring an action against someone cheating the public, on behalf of the government and himself as a taxpayer/citizen. The bill became essentially inoperative through a series of court decisions which held that no one could bring a qui tam action on the basis of information already in the hands of the government--and in this day and age, that is arguably ALL information! [The Law Review articles of Northwestern University (Vol 67, No. 446 (1972)) and UCLA (Vol. 20, No. 778 (1973)) describe in detail the history of the Act and how it was emasculated by the time of World War II.]

HR 1975: AMENDMENTS TO RESTORE THE 1863 ACT

I've attached a Ramseyer of the current law and how the bill I've introduced would change the law. In short, in the false claims section of the law my bill would (1) subject military personnel to the prohibitions on participating in a false claim, (2) make it clear that the sale to the U.S. of defective or improperly tested products would constitute a false claim, and (3) increase the penalty for such actions.

In the qui tam section, it would make it clear that (1) an action against the filer of a false claim may not be dismissed if the Government does not institute appropriate action to correct the violation, (2) a case may not be dismissed just on the grounds that the information was in the hands of the government, (3) the rewards for bringing a qui tam should be more realistic in light of what would otherwise be grossly excessive rewards on a large contract, and (4) court costs may be authorized from the defendant to the bringer of the action.

REASONS FOR THE 1863 ACT REPEATED TODAY

I've also attached a description of the origin of the bill. The Civil War, which saw the first billion dollar Congress, was of course a time of rushed, massive spending on the military. The flood of spending brought out a rash of crooks and shoddy contractors. The parallels with today are striking! Our great-grandfather predecessors decided to fight fire with fire: if so much money was flowing that many were tempted to cheat, then we should enlist citizens to fight corruption and offer rewards to those who put their careers and even their lives on the line by reporting corruption.

With today's massive flows of money to the Pentagon, NASA, and others, I think it is worth trying again. Would it work? I think so.

POSSIBLE AMENDMENTS

I would suggest that the ideas in my bill could be sunset in, say, five years, which would give your Committee time to see how useful the proposal is in operation and what its impact on the courts might be.

You may also want to add language clarifying that there has to be some "knowledge" that a defective product is being sold to the government.

SENATE ACTION

Senator Grassley has a similar but longer bill in the Senate Judiciary Committee. Attached is a summary of some of the differences between his bill and mine. His bill has been reported from Subcommittee to the full Committee. There are rumors that some in the Senate want to block the bill. If true, I would suggest that is a compliment to what an important tool this could be to ensure that contractors give the public a full dollar's value. I would urge the House to take up this fight as soon as possible.

CONCLUSION

I firmly believe that being able to win a significant reward for reporting malfeasance will provide the economic freedom to enable more employees to do their civic duty.

FALSE CLAIMS AND QUI TAM ACT AS AMENDED BY H.R. 1975
A RAMSEYER

31 USC 3729 False Claims

A person ~~not a member of an armed force of the United States~~ is liable to the United States Government for a civil penalty of ~~$2,000~~ $10,000, an amount equal to 2 times the amount of damages the Government sustains because of the act of that person, and costs of the civil action, if the person--

(1) knowingly presents, or causes to be presented, to an officer or employee of the Government or a member of an armed force a false or fraudulent claim or a claim for a defective or improperly tested product for payment or approval;

(2)-(6) [no change]

31 USC 3730 Civil actions for false claims

(a) The Attorney General diligently shall investigate a violation under section 3729 of this title. If the Attorney General finds that a person has violated or is violating section 3729, the Attorney General may bring a civil action under this section against the person. The person may be arrested and bail set for an amount of not more than $2,000 and 2 times the amount of damages sworn to in an affidavit of the Attorney General.

(b)(1) A person may bring a civil action for a violation of section 3729 of this title for the person and for the United States Government. The district courts of the United States have jurisdiction of the action. Trial is in the judicial district within whose jurisdictional limits the person charged with a violation is found or the violation occurs. An action may be dismissed only if the court and the Attorney General give written consent and their reasons for consenting.

(2) A copy of the complaint and written disclosure of substantially all material evidence and information the person possesses shall be served on the Government under rule 4 of the Federal Rules of Civil Procedure (28 App. USC). The Government may proceed with the action by entering an appearance by the 60th day after being notified. The person bringing the action may proceed with the action if the Government--

> (A) by the end of the 60-day period does not enter, or gives written notice to the court of intent not to enter, the action; or
>
> (B) does not proceed with the action with reasonable diligence

within 6 months after entering an appearance, or within additional time the court allows after notice.

(3) If the Government proceeds with the action, the action is conducted only by the Government. The Government is not bound by an act of the person bringing the action.

(4) ~~Unless the Government proceeds with the action, the court shall dismiss an action brought by the person on discovering the action is based on evidence or information the Government had when the action was brought~~. [If the Government does not proceed with the action, the court shall dismiss an action brought by the person unless the person demonstrates--

(A) that the person informed the head of the department or agency concerned of the evidence or information on which the action is based; and

(B) that the Government has not, within six months thereafter, instituted appropriate action to correct the violation.]

(c)(1) If the Government proceeds with the action, the person bringing the action may receive an amount the court decides is reasonable for disclosing evidence or information the Government did not have or had failed to act upon when the action was brought. The amount may not be more than ~~10~~ 1 percent of the proceeds of the action or settlement of a claim or such greater amount not to exceed $1,000,000 as the court determines to be fair and reasonable compensation, and shall be paid out of those proceeds. The person may also receive an amount for reasonable expenses the court finds to have been necessarily incurred and costs awarded against the defendant.

(2) If the Government does not proceed with an action, the person bringing the action or settling the claim may receive an amount the court decides is reasonable for collecting the civil penalty and damages. The amount may not be more than ~~25~~ 1 percent of the proceeds of the action or settlement , or such greater amount not to exceed $1,000,000 as the court determines to be fair and reasonable compensation and shall be paid out of those proceeds. The person may also receive an amount for reasonable expenses the court finds to have been necessarily incurred and costs awarded against the defendant.

(d) The Government is not liable for expenses a person incurs in bringing an action under this section.

OF TOILET SEATS AND SWAY-BACK MULES

HON. FORTNEY H. (PETE) STARK

OF CALIFORNIA

IN THE HOUSE OF REPRESENTATIVES

Monday, April 22, 1985

● Mr. STARK. Mr. Speaker, every day it seems there is a new horror story of screwups in the purchase of weapons, of excessive charges, of shoddy equipment, of falsified or illegal billings.

I have just introduced a bill to help stop this parade of abuse by substantially encouraging whistleblowing over false charges, defective equipment, and other frauds against the taxpayer and Federal Government. This bill, H.R. 1975, amends the *False Claims* Act of 1863 to make it easier for a citizen to be rewarded for bringing a civil suit, on behalf of the entire Government, against a person defrauding the Nation's taxpayers. My bill amends what is known as the qui tam process.

It is sort of fun to examine the origins of the 1863 law. There are many parallels to today's situation.

The Civil War, of course, resulted in an explosive growth in Federal spending, and we reached our first billion-dollar Congress. The War Department was totally unprepared for war and for what became the total mobilization of the Nation. While hundreds of thousands of Americans died bravely, and several million of our then small population served honorably in uniform, the war also brought out the worst in people. Contractors appeared who sold shoddy, dangerous, or worthless merchandise. There were military men who extorted contractors or took kickbacks and gratuities from contractors, and politicians who participated in the uncontrolled spending.

Today, we again have a massive military buildup, greater in real dollar spending than our spending during the Korean and Vietnamese Wars. Today, we have contractors who knowingly sell defective microchips to our armed services for use in life and death situations. We also have contractors who take money meant to buy defense and spend it on advertisements and model ships and planes for the desks of politicians. We have military men who are contract liaison officers for particular giant corporations who resign and take jobs with those companies. Today we have officers who cover up how poorly major weapons system work rather than admit the failures and shoddiness which will kill thousands of our men on some battlefield of the future. Today, we have a War Department which allows builders to certify the quality of their own work, with no safeguards on behalf of the taxpayer. Today, we have politicians who urge the purchase of weapons which are unneeded or obsolete in order to bring home "the bacon" to hometown companies.

The immediate origin of the 1863 False Claims Act was a report (37th Congress, H. Rept. 49) by a special committee of the House "appointed to inquire into all the facts and circumstances connected with contracts and agreements by or with the Government growing out of its operations in suppressing the rebellion." In best congressional style, the committee collected over 3,000 pages of material and held field hearings—and did result in saving the Government millions of dollars. The main part of their report was 41 charges (of which 36 were upheld in court-martial) against a Maj. Justus McKinstry, Quartermaster for the U.S. Army at St. Louis.

McKinstry was clearly a cad—and in the circumstances, the equivalent of a traitor. But what he did then, and what caused an outraged Congress to pass a qui tam law, are duplicated in today's shoddy sales, cover-ups, and kickbacks.

Let me list just three of the charges.

> Major Justus McKinstry, on or about the twentieth day of August, 1861, having need to purchase a large number of artillery horses and cavalry horses for his department, did not and would not purchase the same in the market nor for the market value; but without any advertisement for proposals, authorized one Benjamin F. Fox . . . to furnish the same to him at one hundred and nineteen dollars each for cavalry horses, and one hundred and fifty dollars each for artillery horses . . . the market value of which was about ninety dollars each and . . . one hundred dollars each (respectively).

Sounds like sole source procurement, that ends up with absurd, sweetheart deals for coffeemakers, toilet seats, and other excessive costs.

> Major McKinstry did on the first day of July 1861, and on divers days between that day and the sixth October . . . purchase for his department a large number of mules at one hundred and nineteen dollars each—viz altogether about one thousand mules—which were unfit for the service, and almost worthless, for being too old or too young, blind, weak-eyed, damaged, worn out, or diseased . . . Major McKinstry, acting in that behalf in gross carelessness and disregard of the interest of the service, to the waste and squandering of the public funds.

At least the men in the field could eat the mules. What the modern Army will do with the new Divad air defense gun in a battle is more questionable. Those who avoid battlefield condition tests of the Divad and the Bradley Armored Personnel Carrier are more than buying worthless mules—they are buying weapons that will kill our own forces.

> McKinstry, on or about the 27th September, 1861, at St. Louis, having need to purchase overcoats for his department, did not and would not purchase the same in the market nor for the market price; but, without any advertisment for proposals, authorized Child, Pratt & Fox to furnish the same to him; and when they had purchased then and there from Martin & Brothers 893 overcoats for the price of seven dollars and fifty cents each, he, said McKinstry, then and there purchased the same 893 overcoats from Child, Pratt & Fox for $10.50 each . . . He, said McKinstry, thereby then and there intending to secure to Child, Pratt & Fox, and others in collusion with them, large gains, to the waste of the public funds.

Once more a lack of competitive bids and sweetheart-deals. I wonder what the difference is from this and contracting officers who refuse to buy the best product at the lowest price—whether it be the Northrup Tigershark or new Israeli armor technologies, but instead insist on working with the contractors they have always known and loved.

The qui tam bill made sense in 1863 to deal with the McKinstry's of the world. The courts over a century have made it an inoperable law. In this new, and similar era of wild military spending, we should renew the old False Claims Act to bring more integrity to Government procurement.●

WILLIAM V. ROTH, JR., DELAWARE, CHAIRMAN

TED STEVENS, ALASKA
CHARLES McC. MATHIAS, JR., MARYLAND
WILLIAM S. COHEN, MAINE
DAVE DURENBERGER, MINNESOTA
WARREN B. RUDMAN, NEW HAMPSHIRE
THAD COCHRAN, MISSISSIPPI
THOMAS F. EAGLETON, MISSOURI
LAWTON CHILES, FLORIDA
SAM NUNN, GEORGIA
JOHN GLENN, OHIO
CARL LEVIN, MICHIGAN
ALBERT GORE, JR., TENNESSEE

FRANKLIN G. POLK, CHIEF COUNSEL AND STAFF DIRECTOR
MARGARET P. CRENSHAW, MINORITY STAFF DIRECTOR

United States Senate
COMMITTEE ON
GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510

STATEMENT OF

SENATOR WILLIAM S. COHEN

SENATOR WILLIAM V. ROTH

AND

SENATOR CARL LEVIN

Before the

HOUSE JUDICIARY SUBCOMMITTEE ON ADMINISTRATIVE LAW
AND GOVERNMENTAL RELATIONS

February 5, 1986

Mr. Chairman, we want to commend you for holding these hearings to address what many of us consider to be an extremely serious problem -- fraud against the government. We appreciate the opportunity to present testimony this morning on legislation we've proposed, S. 1134, the Program Fraud Civil Remedies Act, that we believe goes a long way toward solving this problem.

Fraud in federal programs is pervasive, affecting benefit and assistance programs, as well as programs for mortgage insurance, crop subsidies, disaster relief, and the like. Procurement fraud, in particular, has seemingly flourished in the past few years with the plethora of reports on mischarging, cross-charging, and egregious overcharging.

Judicial remedies are available to penalize and deter such fraudulent behavior. For small-dollar cases, however, the cost of litigation often exceeds the amount recovered, thus making it economically impractical for the Justice Department to go to court. The government is consequently left without an adequate remedy for many small-dollar cases.

In one case, for example, the Defense Department discovered that a contractor who operated a parts store on ten different military bases was illegally inflating parts prices. While the total alleged fraud amounted to over $50,000, no single base was defrauded for more than $6,000. Each of the cases was presented to a separate U.S. Attorney, but was declined at each office because the dollar value was too low.

Unfortunately, this case is not an isolated example. A 1981 General Accounting Office report, "Fraud in Government Programs: How Extensive Is It? How Can It Be Controlled?," reviewed more than 77,000 fraud cases committed against the government during a three-year period and found that, of those cases referred to the Justice Department, less than 40 per cent were prosecuted.

The consequence, according to the Justice Department, is that the federal government loses "tens, if not hundreds, of millions of dollars" to fraud each year. Beyond the actual monetary loss, fraud in federal programs also erodes public confidence in the administration of these programs by allowing ineligible persons to benefit from them.

S. 1134, the Program Fraud Civil Remedies Act, which we introduced along with Senators Nunn, Chiles, Gore, Grassley, and Boren, would provide agencies with an administrative remedy for false claim and statement cases under $100,000 which the Justice Department has declined to litigate. S. 1134 was recently reported from the Governmental Affairs Committee report with only one dissenting vote, and is strongly supported by the General Accounting Office, the Justice Department, the Inspectors General, the Administrative Conference of the United States, and the Federal Bar Association.

We believe it is important to emphasize, Mr. Chairman, that S. 1134 would not create a new category of offenses. Rather, it simply provides an administrative alternative, patterned largely after the civil False Claims Act, that would capture only that conduct already prohibited by federal civil and criminal laws.

The benefits of establishing an administrative proceeding for adjudicating small-dollar false claim and statement cases, as provided in S. 1134, are numerous. First, it would allow the government to recover money that, up until now, has been irretrievably lost to fraud. Second, it would provide a more expeditious and less expensive procedure to recoup losses, compared with the extensive investments of time and resources required to litigate in federal court. Finally, such an administrative remedy would serve as a deterrent against future fraud by dispelling the perception that small-dollar frauds against the government may be committed with impunity.

An additional benefit is that we know such a remedy can work. Under the Civil Monetary Penalties Law (CMPL), the Department of Health and Human Services is authorized to impose penalties and assessments administratively against health-care providers who knowingly or with reason to know submit false claims for services. Since implementation of the CMPL, HHS has been able to recover over $15 million resulting from 117 settlements and litigated cases.

Before we discuss the major issues that were considered during our Committee's deliberations on S. 1134, we would like to provide a brief description of how the bill would work.

Under S. 1134, a typical case would begin with an investigation conducted by the agency's investigating official, usually the Inspector General. The IG's findings would be transmitted to the agency's reviewing official -- an individual separate from the IG's office -- who would independently evaluate the allegations to determine whether or not there is adequate evidence to believe that a false claim or statement has been submitted.

If so, the matter would be referred to the Justice Department for consideration. This procedure ensures that the Department will have an opportunity to review the charges and elect, if it so chooses, to litigate in federal court. If the Department declines litigation and does not veto administrative action, the agency may commence administrative proceedings against the person alleged to be liable. The reviewing official would notify the person of the charges and of his or her right to a hearing.

An Administrative Law Judge -- an independent, trained hearing examiner -- would conduct the hearing to determine whether or not the person is liable and the amount of penalty and assessment, if any, to be imposed. The hearing itself would be conducted pursuant to the due process safeguards of the Administrative Procedure Act, which entitles the person to a written notice of the allegations, the right to be represented by counsel, and the right to present evidence on his or her own behalf. The bill even goes beyond these APA protections by granting the person limited discovery rights.

Throughout the consideration of this legislation, we have consulted with the Justice Department, the Inspectors General, the American Bar Association Public Contract Law Section, defense industry associations, federal employees' organizations, and other interested individuals and groups. We carefully considered the comments provided by these organizations and individuals and incorporated many of their recommendations into S. 1134 as reported by the Governmental Affairs Committee. While the Committee considered a wide range of issues, we thought it might be helpful to focus our testimony on the two issues that consumed much of the debate.

Probably the most important issue considered is the knowledge standard required for establishing liability. Under S. 1134, the government would not only have to prove that a claim is false, but also that the person either "knows or has reason to know" that the claim is false. Judging from the different interpretations of the "knows or has reason to know" standard expressed by witnesses at our hearing, we felt that a definition was needed to promote fairness and consistency.

S. 1134 defines the standard to cover those persons who either have actual knowledge that a claim or statement submitted is false, or are grossly negligent of the duty to make such inquiry as would be reasonable and prudent to conduct under the circumstances to ascertain the true and accurate basis of the claim or statement. This definition is adopted, in part, from the pattern jury instruction which judges use to instruct lay jury members regarding what the law has traditionally required as a basis for finding knowledge, and is consistent with certain circuit court decisions interpreting the knowledge standard under the False Claims Act.

The imposition of this scienter requirement is intended to draw the line of liability between "gross" and "mere" negligence -- that is, a person's gross neglect of facts which are known or readily discoverable upon reasonable inquiry should result in liability, while errors resulting from mistake, momentary thoughtlessness, or inadvertence should not. The definition clarifies, therefore, that a person who makes a false claim or statement through mere negligence does not meet the requisite scienter requirement and would not be held liable under the Act. Only those individuals who are extremely careless, who demonstrate an extreme departure from ordinary care, would be subject to liability.

The affirmative duty, as required under the definition, to "make such inquiry as would be reasonable and prudent to conduct under the circumstances" is premised on our belief that a person seeking government business or benefits has an inherent obligation to "advise the government of the true and accurate factual basis of [his or her] claim." United States v. Cooperative Grain and Supply Co., 476 F.2d 47, 55 (8th Cir. 1973). Given the wide range of programs to which S. 1134 applies, we intend that this "duty to make inquiry" language should be interpreted to allow for the consideration of factors relative to the sophistication and resources of the person, the amount of time available, and the costs involved. Liability would, as a result, be tailored to the program, with persons judged according to the general conduct of others participating in the same program.

Within the corporate context, this duty language would limit personal liability for the submission of a false claim to those individuals who -- based on their job responsibilities and their substantive role in advancing the claim -- knew or had reason to know that the claim was false. While this does not mean that the corporate vice president, responsible for certifying the truth and accuracy of the company's claims, has to redo the work of his or her subordinates, the executive could be found liable for failing to take any steps whatsoever to ensure the truth and accuracy of the claims.

The second issue concerns the need for testimonial subpoena authority. Investigating officials are authorized under S. 1134, for purposes of conducting an investigation, to require by subpoena the attendance and testimony of witnesses. We believe, as do the Inspectors General, that this authority would be an essential tool in helping the government prove the elements required under the bill to establish liability, since few who defraud the government leave a sufficicent "paper trail" to enable proof of fraud by documents alone.

Concerns have been raised, primarily by some defense industry representatives, that this testimonial subpoena authority is "unfettered" and "unprecedented." Neither is the case.

Under S. 1134, an Inspector General may only subpoena a witness when the subpoena is necessary to the investigation. The bill was amended in Committee to provide other significant limitations to safeguard against abuse. First, the Justice Department is given veto authority over its use. S. 1134 requires that the investigating official, prior to issuing a subpoena, must first notify the Attorney General, who then has 45 days within which to disapprove the subpoena. Second, S. 1134 limits the use of this authority only to the 18 statutory Inspectors General, appointed by the President and confirmed by the Senate; the IGs may not delegate this authority.

In addition to these safeguards, S. 1134 provides due process protections for those individuals subpoenaed to testify. These protections afford persons subject to testimonial subpoenas a notice of the date, time and place at which the testimony will be taken; the right to be accompanied, represented and advised by an attorney; an opportunity to examine and, within certain limits, to make changes in the transcript of the recorded testimony; and the right to a copy of the transcript. The bill also specifies that the testimony is to be taken in the judicial district in which the subpoenaed person resides or transacts business, or in any other place agreed to by the person and the investigating official taking the testimony. The person subpoenaed would be paid the same fees and mileage paid to witnesses in U.S. district court.

Moreover, there is ample precedent for granting investigatory testimonial subpoena authority to executive departments and regulatory agencies. The American Law Division of the Congressional Research Service compiled a list of more than 65 statutes that provide such authority, ranging from the broad power granted to the Department of Health and Human Services for investigations of claims for Social Security retirement and disability benefits to the authority given to the Department of Agriculture for investigations under the Horse Protection Act.

Opponents of S. 1134 have focused their criticisms on these two issues and have recommended, on the one hand, that a more stringent knowledge standard be adopted, while on the other hand, that the investigative tool helpful in proving knowledge be stricken. We rejected these proposals and respectfully recommend that you do so as well. We might add that, on these two issues, S. 1134 is consistent with the provisions of Senate legislation to amend the False Claims Act, S. 1562. The Senate Judiciary Committee adopted our knowledge standard virtually word for word and provided civil investigative demand authority (the functional equivalent to testimonial subpoena authority) for Justice Department investigations under the False Claims Act.

Without going into as much detail, we would like to briefly outline several other improvements made to the bill from earlier years' versions. S. 1134 would:

o strengthen the due process protections afforded to persons subject to the administrative proceedings by spelling out the specific protections provided by the Administrative Procedure Act and by providing limited discovery rights;

o designate Administrative Law Judges, or ALJ-like officials for agencies not covered by the Administrative Procedure Act, to serve as "hearing examiners;"

o clarify the linkage between a Program Fraud finding of liability and separate suspension or debarment action;

o apply the $100,000 jurisdictional cap to groups of related claims submitted at the same time;

o clarify that the assessment for false claims applies to double the amount claimed in violation of the Act, not double the amount of the claim;

o ensure independent prosecutorial review by clearly separating the positions of investigating official and reviewing official; and o substitute the term "remedies" for "penalties" throughout the bill to emphasize that the Program Fraud Civil Remedies Act is a remedial, and not a penal, statute.

In conclusion, Mr. Chairman, we believe that the enactment of an administrative remedy for small-dollar fraud cases is long overdue. The fact that the Justice Department declines prosecution in most cases where the government does not sustain a significant monetary loss is an open invitation to those individuals tempted to defraud the federal government. Until federal agencies are given the power to bring administrative proceedings in such cases, these "nickel and dime" frauds will continue unabated. The Program Fraud Civil Remedies Act will help combat fraud without compromising the rights of individuals accused of wrongdoing. We look forward to working with you and your colleagues to enact this bill this year.

Mr. Chairman, we ask that letters from the General Accounting Office, the Justice Department, the Inspectors General, and other organizations endorsing S. 1134 be included in the Committee's printed hearing record following our statement.

OCT 22 1985

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. [illegible]

October 21, 1985

B-204345

The Honorable William S. Cohen
Chairman, Subcommittee on Oversight of
Government Management
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

This is to express our continued support for the enactment of legislation to authorize federal agencies to levy administrative penalties for certain false claims and statements made to the United States. We firmly believe such legislation would further strengthen the government's overall ability to combat fraud, waste and abuse within government programs.

As you know, we have testified in support of bills similar to S.1134, the Program Fraud Civil Penalties Act of 1985, before the Senate Governmental Affairs Committee on two previous occasions. In 1982 we expressed our support of S. 1780, and in 1983 we supported the enactment of S. 1566. Our position stems from a 1981 report entitled "Fraud in Government Programs:--How Extensive Is It--How Can It Be Controlled?" (AFMD-81-57; May 7, 1981), in which we recommended that the Congress consider enacting legislation giving agencies the authority to administratively impose civil money penalties against persons who defraud the government. Our study showed that the Department of Justice declined to prosecute about 61 percent (7,800) of 12,900 fraud cases referred for prosecution. In many of those cases Justice declined to prosecute on the grounds that the cases involved small dollar amounts, had no prosecutive merit, or jury appeal. We believed, and continue to believe, that the establishment of an administrative penalty system could provide the government with a viable alternative remedy in such cases. Such a system would not only strengthen the government's ability to recover misappropriated funds, but also serve as a deterrent against others committing similar offenses.

We are pleased to see that the bill under consideration by the Congress--S. 1134--has received strong support from the Justice Department and the Inspector General community. In Justice's testimony before your subcommittee this past June, it recognized that the administrative resolution of fraud cases involving small amounts of money would offer the government an efficient and effective alternative to litigating such cases in federal courts, usually a lengthy and costly process. Representatives from the Inspector General community also provided numerous examples during their testimony of where S. 1134 would be most appropriately used. The Deputy Inspector General of the Department of Defense (DOD) cited a case in which a contractor operated a parts store on 10 different military bases. He illegally inflated parts prices on each contract. While the total fraud amounted to over $50,000, no single base was defrauded for more than $6,000. Each case was presented to nine separate United States Attorneys, and was declined at each office because the dollar value was too low. Seeking an administrative penalty such as provided for in S. 1134 would be a viable alternative remedy in such a case.

Your subcommittee has made several notable changes to the proposed legislation since our 1983 testimony on S. 1566, the predecessor of S. 1134, such as: (1) modifying the standard of liability to authorize the imposition of penalties when a person submits claims or statements that he knows or has reason to know are false; (2) clarifying the effect of a finding of liability under an administrative proceeding, as not automatically requiring a contractor's suspension or debarment; (3) clarifying that the assessment for false claims applies to double the amount falsely claimed rather than double the amount claimed; and (4) separating the position of investigating officials and reviewing officials so as to ensure independent prosecutorial review. Although we have not had time to thoroughly review the other subcommittee amendments, we consider the above changes, primarily designed to further insure that the administrative penalty system is fairly and objectively administered, to be improvements over the prior bill.

We commend your particular interest and efforts in this area, and we look forward to working with Congress in insuring the enactment of legislation authorizing agencies to levy administrative penalties, as a means of combating fraud, waste and abuse within government programs.

Sincerely yours,

for Milton J. Socolar

Comptroller General
of the United States

U.S. Department of Justice

Office of Legislative and Intergovernmental Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

NOV 4 1985

NOV 04 1985

Honorable William S. Cohen
Chairman
Subcommittee on Oversight of Government Management
Committee on Governmental Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

The Department of Justice strongly supports S. 1134, the Program Fraud Civil Remedies Act, as it was reported from the Oversight of Government Management Subcommittee. Both you and Senator Roth are to be commended for your leadership in moving forward with this important piece of legislation, and we urge you to expedite action at the full committee so that the bill can come to the floor of the Senate in this session.

The Department, the Inspectors General and this Committee have long recognized the need to develop some alternate dispute resolution mechanism for small fraud cases. Because of limited Justice Department resources and the growing caseload burden in the federal courts, it often is not cost effective to file suit in district court to collect on small-dollar frauds. Consequently, unless these cases are simply to be written off, we must develop a mechanism, such as S. 1134, which provides the government with a meaningful remedy.

We believe that the Committee has crafted an excellent bill, preserving all necessary due process protections without unduly complicating and delaying the adjudication process. The bill closely tracks the False Claims Act, the Civil War-era statute which the government has relied upon to bring civil and criminal fraud prosecutions, and follows the better-reasoned holdings of the courts under that statute. Notably, we believe that S. 1134 adopts a reasonable compromise in imposing liability on a person who "knows or has reason to know" that a claim was false. This standard would prohibit a corporate officer from avoiding liability by insulating himself from knowledge of the truth or falsity of the claims he is submitting. The bill correctly holds persons claiming money from the government to the duty to make "such inquiry as would be reasonable and prudent to conduct under the circumstances." Persons doing business with the

United States should be under an obligation to make reasonable efforts to ensure that the claims which they submit are accurate.

We also believe that the bill properly requires the United States to prove a violation by a preponderance of the evidence -- the traditional standard of proof in civil litigation. Raising the burden to that of clear and convincing evidence, as some have suggested, would, in our view, place an unwarranted burden on the government. For instance, the burden of proof in civil treble damage actions filed under the antitrust laws has always been a preponderance of the evidence. There is no justification for imposing any greater burden on the government in a program fraud proceeding.

Finally, Mr. Chairman, the Department of Justice and the Administration continue to object to section 804(a)(1)(C) of the bill, authorizing the Inspectors General to compel the testimony of witnesses. We do not believe that there is a demonstrable justification for such extraordinary powers and we are seriously concerned with the potential this provision creates for interference with ongoing criminal investigations. While we recognize that the proponents of S. 1134 have made efforts to accommodate our concerns on this issue, the proposed procedure for Department of Justice review of testimonial subpoenasis simply unworkable. Our views on this issue are set out in detail in the Deputy Attorney General's letter of August 26, 1985.

Sincerely,

Phillip D. Brady

PHILLIP D. BRADY
Acting Assistant Attorney General

cc: Attached List

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

OCT 21 1985

The Honorable William S. Cohen
United States Senate
Washington, D.C. 20501

Dear Senator Cohen:

The Committee on Governmental Affairs is soon to consider S. 1134, the "Program Fraud Civil Remedies Act of 1985," reported out by the Subcommittee on Oversight of Government Management. The members of the Legislation Committee of the President's Council on Integrity and Efficiency (PCIE), representing the seventeen statutory Inspectors General, wish to express our unanimous and enthusiastic support for this important legislation. This bill would establish an administrative mechanism to impose civil monetary penalties and assessments for fraudulent claims and statements made to the United States. As the Federal officials who are charged with the formidable task of preventing and detecting fraud and abuse in our respective agencies, we strongly believe that the civil monetary penalties authority will provide an invaluable tool in efforts to combat fraud against the United States.

Experience has shown that the Justice Department does not possess the resources necessary to prosecute all meritorious civil fraud cases referred to it by the Inspectors General and by others. Further, certain cases may lack prosecutive merit for a variety of reasons -- for example, loss to the Government is small or impossible to calculate or there is insufficient jury appeal. The result is that often the United States does not have the opportunity to recoup its losses, both actual damages and consequential damages, such as the cost of detection and investigation.

The bill to be considered by the Committee, S. 1134, offers an alternative to judicial remedies for fraud - an alternative that promises numerous benefits to the public. First, the authority would act as a powerful deterrent, particularly in those types of cases in which the Justice Department does not usually pursue civil action or criminal prosecution. Second, an administrative mechanism for resolution of fraud cases is both expeditious and relatively inexpensive. Third, an administrative alternative will relieve the Department of Justice of the burden of referrals of "smaller" fraud cases, thereby freeing that Department to more effectively allocate its own resources to the most significant cases. Finally, the proposed civil monetary penalties authority would provide a means of recovering sums that, heretofore, have been irretrievably lost to fraud.

In conclusion, we strongly urge the Committee to act favorably and expeditiously on S. 1134. At a time when every dollar lost to fraud adds to the existing budget deficit, we feel it is imperative to do whatever can be done for the taxpayers, and for the beneficiaries of Federal programs, in order to make sure that every Federal dollar is properly spent. We believe S. 1134 is one important means of moving towards that objective.

Sincerely yours,

Richard P. Kusserow

Richard P. Kusserow
Inspector General

Chairman, Legislation Committee
President's Council on
Integrity and Efficiency

Members of Legislation Committee:

Sherman M. Funk
Inspector General
U.S. Department of Commerce

John V. Graziano
Inspector General
U.S. Department of Agriculture

James R. Richards
Inspector General
U.S. Department of Energy

Joseph Sherick
Inspector General
U.S. Department of Defense

Mary F. Wieseman
Inspector General
Small Business Administration

DEPARTMENT OF DEFENSE
INSPECTOR GENERAL
WASHINGTON, D.C. 20301

14 NOV 1985

Honorable William S. Cohen
Chairman
Subcommittee on Oversight of Government
  Management
Committee on Governmental Affairs
United States Senate
Washington, D.C. 20510

NOV 14 1985

Dear Mr. Chairman:

Your staff has requested that I provide additional views on the Bill S. 1134, the "Program Fraud Civil Penalties Act of 1985." I understand this Bill is scheduled for mark-up by the Senate Governmental Affairs Committee in the near future.

I strongly support this legislation. Many frauds against Federal programs are not prosecuted because the Department of Justice often does not have sufficient resources to devote to fraud cases covered by this Bill. Since the Government has traditionally relied upon judicial proceedings to recover for false claims and statements, if a case is not prosecuted in Federal court the Government is left without any effective remedy.

The Program Fraud Civil Penalties Act would allow Departments such as the Department of Defense to impose an administrative penalty for false claims and statements, and to recover damages. The Department of Health and Human Services obtained similar statutory power in 1981 which has been highly successful in combating false claims in the Medicare and Medicaid programs. The Bill would allow a similar authority to be used in areas such as Defense procurement fraud.

Contrary to the assertions of certain contractors and organizations who oppose this Bill, it does not create a new category of offenses, nor does it deny due process. The Bill is designed to place an administrative penalty upon conduct which is already prohibited by Federal criminal and civil statutes relating to false claims and statements. Furthermore, the Supreme Court has repeatedly upheld other remedial statutes which have contained due process provisions similar to S. 1134.

Sincerely,

Joe Sherick

Joseph H. Sherick
Inspector General

ADMINISTRATIVE CONFERENCE OF THE UNITED STATES
2120 L STREET, N.W., SUITE 500
WASHINGTON, D.C. 20037
(202) 254-7020

October 18, 1985

OFFICE OF
THE CHAIRMAN

Honorable William S. Cohen
Chairman
Subcommittee on Oversight of
  Government Management
Committee on Governmental Affairs
U. S. Senate
Washington, D.C. 20510

Dear Senator Cohen:

This is in response to your letter of October 9, requesting the comments of the Administrative Conference on S. 1134, the Program Fraud Civil Remedies Act of 1985.

We understand that the bill is at present in mark up and its details are subject to revision. Accordingly, we shall address only the major features of the bill.

S. 1134 would provide an administrative procedure for imposing civil penalties for false claims and statements made to the United States in connection with agency programs. It would cover a broad range of agencies and programs and be administered by the respective agencies. The procedure would be available only for relatively small cases, i.e., those in which the amount involved in the claim was $100,000 or less. The maximum penalty would be $10,000 for each false claim or statement, plus twice the amount of any claim or portion of a claim. The procedure prescribed by the bill would include an initial investigation of the suspected false claim or statement by an investigating official who reports his findings to a reviewing official. If the reviewing official determines there is adequate evidence to indicate liability for civil penalties, he would refer the case for a formal adjudicative hearing under the Administrative Procedure Act, 5 U.S.C. §§554, 556 and 557, presided over by an administrative law judge of the agency. (We understand that proceedings in the military departments would not be governed by the Administrative Procedure Act but by procedures prescribed in the bill and generally similar to those in the APA. We have not studied these provisions of the bill, and we limit our comments to those proceedings governed by the APA.) If the administrative law judge determines on a preponderance of the evidence that the respondent had made a false or fraudulent claim or statement, he could impose the appropriate penalty. The respondent could obtain review of the ALJ decision by the agency head or his delegate and judicial review of an adverse agency determination in the United States Court of Appeals. Such review would be on the administrative record in accordance with the substantial evidence rule, 5 U.S.C. §706(e).

As you know, in 1972 the Administrative Conference adopted its Recommendation No. 72-6, Civil Money Penalties as a Sanction, 1 CFR §305.72-6 (copy enclosed). In Part B of that recommendation we urged that agencies consider the possible advantages to their enforcement programs of a procedure for administrative imposition of civil money penalties for regulatory violations, and we suggested some of the factors the presence of which in the regulatory scheme would argue for such administrative imposition. The preamble of the recommendation explains the basis for our urging consideration of administrative imposition:

> Under most money penalty statutes, the penalty cannot be imposed until the agency has succeeded in a *de novo* adjudication in federal district court, whether or not an administrative proceeding has been held previously. The already critical overburdening of the courts argues against flooding them with controversies of this type which generally have small precedential significance.
>
> Because of such factors as considerations of equity, mitigating circumstances, and the substantial time, effort and expertise such litigation often requires in cases usually involving relatively small sums (an average of less than $1,000 per case), agencies settle well over 90% of their cases by means of compromise, remission or mitigation. Settlements are not wrong *per se*, but the quality of the settlements under the present system is a matter of concern. Regulatory needs are sometimes sacrificed for what is collectible. On the other hand, those accused sometimes charge that they are being denied procedural protections and an impartial forum and that they are often forced to acquiesce in unfair settlements because of the lack of a prompt and economical procedure for judicial resolution. Moreover, several agency administrators warn that some of the worst offenders, who will not settle and cannot feasibly be brought to trial, are escaping penalties altogether.

At the time the recommendation was adopted comparatively few statutes provided for administrative, as opposed to judicial, imposition of civil penalties.[1] However, in recent years, in response in part, perhaps, to the Conference recommendation and, certainly, to the increasingly urgent need to alleviate the burden on the Federal courts, Congress has frequently provided for administrative imposition under procedures similar to those set forth in S. 1134.[2] In 1979 the Conference in its

---

[1] The report of the Conference's consultant concluded that only four statutory schemes provided for "true administrative imposition," *i.e.*, without a *de novo* judicial determination. Goldschmid, *An Evaluation of the Present and Potential Use of Civil Money Penalties as a Sanction by Federal Administrative Agencies*, 2 ACUS 896, 907-08.

[2] See, *e.g.*, Migrant and Seasonal Agricultural Worker Protection Act, §503, 29 U.S.C.A. §1853; Medicare and Medicaid Amendments of 1981, P.L. 97-35, Tit. xxi, 42 U.S.C. §1320a-7a; Communications Act Amendments of 1978, §2, 47 U.S.C. §503(b); Toxic Substances Control Act, §16, 15 U.S.C. §2615.

Recommendation No. 79-3, Agency Assessment and Mitigation of Civil Penalties, 1 CFR §305.79-3 (copy enclosed) reaffirmed its support of administrative imposition and welcomed the increased use of such procedures since its 1972 recommendation.

Part B, Paragraph 1 of the Conference recommendation lists some of the factors the presence of which argue for a system of administrative imposition. Among these factors, an anticipated large volume of cases, the relatively small penalties involved, the importance of speedy adjudication, and the unlikelihood that issues of law will arise calling for judicial resolution, all seem common to the range of cases covered by S. 1134. In addition, in many cases the availability of an effective and credible civil penalty remedy may enable an agency to forego a harsher remedy, such as debarment or disqualification from the program. Another factor cited in the recommendation is the availability of an impartial forum in which cases can be efficiently and fairly decided. We have confidence that the procedure provided in S. 1134, an on-the-record adjudicatory hearing before an administrative law judge, offers such a forum. Furthermore, we note that the procedural system provided in the bill (except that which would apply to the military departments, as to which we have reserved comment) fully complies with Paragraph 2 of Part B of our recommendation.

Accordingly, we believe that the general features of S. 1134 are consistent with Conference Recommendations 72-6 and 79-3 and that they merit the favorable consideration of Congress.

Sincerely yours,

Mark S. Fowler

Mark S. Fowler
Acting Chairman

Enclosures

Federal Bar Association

National Headquarters: 1815 H Street, N.W., Washington, D.C. 20006 • (202) 638-0252

District of
Columbia
Chapter

1985-1986

President
Lauren L. Fuller
Attorney at Law

President-Elect
Sarah Hertz
Department of Health
and Human Services

First Vice President
Marsha A. Echols
Office of Mayor M. Barry

Second Vice President
Bonnie L. Gay
Department of Justice

Secretary
John F. Connolly
Federal Home Loan
Bank Board

Recording Secretary
DaCosta V. Mason
Legal Aid Society of D.C.

Treasurer
Joan Seitz Pate
Judge
U.S. Tax Court

*Delegate to National
Council*
Carlos Garza
Department of Energy Board of
Contract Appeals

*Alternate Delegate to
National Council*
Nicholas Allard
Office of Senator
Edward M. Kennedy

NOV 4 1985

November 1, 1985

Senator William S. Cohen
Chairman
Senate Subcommittee on Oversight of
Government Management
Senate Hart Office Building
Room 322
Washington, DC 20510

Re: S. 1134

Dear Senator Cohen:

The D.C. Chapter of the Federal Bar Association through its Committee on the Administrative Judiciary has reviewed S. 1134, the Program Fraud Civil Remedies Act of 1985, and on behalf of the Chapter's 5,000 federal lawyers supports its enactment.

The provisions for selection, appointment, salary and tenure of the administrative adjudicators who will hear and decide civil fraud cases are in accord with longstanding safeguards of the status and decisional autonomy of administrative law judges under the Federal Administrative Procedure Act. Further, the guarantees of procedural due process spelled out in S. 1134 insure that constitutional requirements of fundamental fairness will be observed by the agencies engaged in its enforcement.

We appreciate the opportunity afforded us to participate in the formulation of one of the most important legislative initiatives of the 99th Congress. We believe this bill will significantly strengthen and reinforce the government's efforts to prevent waste, fraud and abuse in federal programs.

Sincerely yours,

Joseph B. Kennedy

Joseph B. Kennedy
Chairman
Committee on the Administrative
Judiciary
Federal Bar Association
District of Columbia Chapter

cc: Jeffrey A. Minsky

BEST COPY AVAILABLE

The Federal Administrative Law Judges Conference

424 NATIONAL LAWYERS CLUB
1815 H STREET, N. W.
WASHINGTON, D. C. 20006

OFFICERS

Glenn Robert Lawrence (DOL)
President
Isaac D. Benkin (FERC)
First Vice President
John J. Mathias (FTC)
Second Vice President
James P. Timony (FTC)
Treasurer
Paul H. Teitler (HHS)
Secretary

EXECUTIVE COMMITTEE

Victor W. Palmer (AGRI)
Arthur T. Shaw (CFTC)
Alfred F. Chatterton (CG)
Francis L. Young (DEA)
Hugh J. Dolan (DOC)
Robert Feldman (DOL)
Everette E. Thomas (DOL)
Melvin Warshaw (DOL)
Elias C. Rodriguez (DOT)
Edward F. Finch (EPA)
Joseph Gonzalez (FCC)
Daniel J. Davidson (FDA)
Bruce L. Birchman (FERC)
Isabelle R. Cappello (FLRA)
Joseph N. Ingolia (FMC)
Joseph B. Kennedy (FMSHRC)
Thomas F. Howder (FTC)
Ainsworth Brown (HHS)
George C. Pierce (HHS)
Pleasant B. Watson (HHS)
Alan W. Heifetz (HUD)
William A. Sher (ICC)
Joseph E. McGuire (INT)
Sidney Harris (ITC)
Robert A. Gritta (NLRB)
Norman Zankel (NLRB)
Morton B. Margulies (NRC)
William E. Fowler (NTSB)
Paul A. Tenney (OSHRC)
Marvin H. Morse (SBA)
Ralph Hunter Tracy (SEC)
Randolph D. Mason (USPS)

James J. O'Meara, Jr. (NLRB)
Past President

November 25, 1985

Mr. Jeffrey A. Minsky
Subcommittee on Oversight of
Government Management,
Committee on Governmental
Affairs
326 Dirksen Senate Office Building
Washington, D.C. 20510

Subject: S. 1134-Program Fraud Civil Remedies Act of 1985

Dear Mr. Minsky:

I am pleased to inform you that, on November 22, 1985, the Executive Committee of the Federal Administrative Law Judges Conference(FALJC) formally voted to endorse and support S. 1134, the Program Fraud Civil Remedies Act of 1985, as it appears in the Committee print dated November 15, 1985.

The FALJC endorsement is embodied within the terms of the enclosed resolution which was adopted by this organization's Executive Committee on November 22.

Please continue to advise us of the Bill's progress. If we may assist you in any way to gain enactment, do not hesitate to call.

Very sincerely,

Norman Zankel

Judge Norman Zankel, Chairman
Legislative Committee

Encl.

cc: Hon. Glenn R. Lawrence
Pres., FALJC

Hon. Joseph B. Kennedy

Please direct written communications regarding this matter to the writer at:

7632 Coddle Harbor Lane
Potomac, MD 20854

Be it RESOLVED that:

The Federal Administrative Law Judges Conference endorses and supports S. 1134, the Program Fraud Civil Remedies Act of 1985, with the understanding that (as provided in the November 15, 1985 print of the Senate Subcommittee on Oversight of Government Management) the hearing officers who will conduct the administrative hearings are either Administrative Law Judges appointed pursuant to 5 USC 3105 or persons who possess Administeative Law Judge qualifications; and who will enjoy the safeguards of the status and decisional autonomy of Administrative Law Judges under the federal Administrative Procedure Act; and further provided that such administrative hearings will be conducted pursuant to the requirements of the federal Administrative Procedure Act to insure that constitutional requirements of procedural due process and fundamental fairness will be observed by the agencies and departments engaged in enforcement of program fraud legislation.

Mr. Glickman. Tomorrow we hear testimony from Senator Grassley, Congressman Ireland, Congressman Bedell, and then private witnesses.

The hearing is adjourned.

[Whereupon, at 1:15 p.m., the subcommittee was adjourned.]

BLANK PAGE

322

FALSE CLAIMS ACT AMENDMENTS

THURSDAY, FEBRUARY 6, 1986

House of Representatives,
Subcommittee on Administrative Law
and Governmental Relations,
Committee on the Judiciary,
Washington, DC.

The subcommittee met, pursuant to call, at 10:20 a.m., in room 2237, Rayburn House Office Building, Hon. Dan Glickman (chairman of the subcommittee) presiding.

Present: Representatives Glickman, Berman, Kindness, and Brown.

Mr. **Glickman**. The Subcommittee on Administrative Law and Governmental Relations will please come to order.

Today we start our second day of hearings on amendments to the False Claims Act, including the Program Fraud Civil Penalties Act. Yesterday we heard from Department witnesses, including the Department of Justice. We also heard from some industry witnesses.

Today we continue the hearings and we are honored to have our distinguished colleague from the Senate, Senator Grassley from Iowa, here.

Senator Grassley has become quite famous around the country for being an independent force and voice in connection with issues of procurement by the Pentagon and exposing fraud and trying to prevent that kind of thing from happening in the future.

Chuck, we are delighted to have you here. Why don't you take the witness chair and you may proceed as you wish.

You entire prepared statement will be inserted in the record, you may read it or submit it, however you wish.

TESTIMONY OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator **Grassley**. I have a shorter version which I will read but I have a longer version for the record. I appreciate very much your holding this hearing. This hearing, under your leadership, is to consider pragmatic reform of our fraud enforcement laws. I commend you and the members of the committee for pursuing this hearing and pursuing an appropriate legislative remedy for fraud against Government.

Also I need to apologize since I will probably have to rush out of here because of Judiciary and Finance Committee work, and also because Secretary Weinberger will be before the Budget Committee this afternoon.

So I have these things that I have to be prepared for.

Evidence of fraud against the Nation's taxpayers is on a steady rise. As with other types of crime and abuses in our society, fraud breeds a culture unto itself. It endures because the opportunity exists and because our ability to counter it is limited by inadequate resources, experience and laws.

Recent months have witnessed a proliferation of fraud cases, and yet so few victories by law enforcement officers on behalf of the taxpayers.

No one knows, of course, exactly how much public money is lost to fraud. Estimates from the General Accounting Office, Department of Justice, and Inspectors General range from hundreds of millions of dollars to more than $50 billion per year. Sadly, only a fraction of the fraud is reported, and an even smaller fraction of the funds recovered.

The False Claims Act has been the Government's primary weapon against fraud, yet is in desperate need of reform. A review of the current environment is sufficient proof that the Government needs help—lots of help—to adequately protect the Treasury against growing and increasingly sophisticated fraud. The solution calls for a solid partnership between public law enforcers and private taxpayers.

On December 12, the Senate Judiciary Committee voted without objection to favorably report to the full Senate S. 1562, the False Claims Reform Act. This bill, which I sponsored along with Senators DeConcini, Levin, Hatch, Metzenbaum, Cohen, and Leahy, will make necessary reforms in our No. 1 litigative tool against government fraud.

I know this subcommittee is considering several pieces of legislation today which contain various portions of what the Senate Judiciary Committee approved in S. 1562. I also understand, Mr. Chairman, that you have introduced a bill dealing with both false claims and program fraud, and I look forward to being of assistance to you in any way I can.

In hearings before the Administrative Practice and Procedure Subcommittee of the Senate Judiciary Committee, Government and non-government witnesses offered three general recommendations for more effective enforcement against fraud: One, increased penalties for more meaningful deterrence; two, enhanced investigative and litigative tools for better detection and monetary recoveries; and three, additional resources to staff the antifraud effort.

The False Claims Reform Act incorporates all these suggestions, but without appropriating new funds to any agency. Instead this legislation is intended to complement the Government's current resources by encouraging private individuals to become actively involved in the war against fraud.

S. 1562 promotes a concept first enacted into law by President Abraham Lincoln in 1863. Lincoln's law permits private individuals aware of fraud to bring suit on behalf of the Government and to receive a portion of the recovery in the action is successful.

Through testimony and interviews we have found that most individuals employed by Government contractors are honest and hard working. Many are also angry and discouraged because they witness and, in some cases, are directed to participate in fraudulent practices. Very few, however, are willing to risk their jobs by "blowing the whistle." Still fewer believe their disclosures will lead to results of prosecution and conviction.

Pessimism about the likelihood of disclosures leading to results is not surprising in light of a 1981 General Accounting Office report which found among all Government fraud referrals, less than 40 percent were prosecuted. More recently, the Department of Defense Inspector General testified that in 1984 more than 2,000 fraud investigations were completed. Yet the Justice Department successfully prosecuted in that same year just 181 cases, including only one against one of the top 100 defense contractor.

In short, S. 1562 would shift the incentives for individuals to come forward by allowing them more involvement in the litigation process as well as increased portions of damage awards. Perhaps most important to persons considering "going public" with this knowledge of fraud are the added legal protections from retaliation due to their disclosures.

The False Claims Reform Act does not create any new Federal enforcement bureaucracy. Instead, it is consistent with other areas of law where the Government has inadequate resources to enforce the laws by itself. For example, with securities laws and regulations, the number of private civil enforcement actions far exceeds those brought by the Government.

Also, in the antitrust area, private citizens in recent years have been responsible for bringing over 90 percent of all civil enforcement actions.

Mr. Chairman, the public, the Congress and even the administration all recognize the magnitude of the fraud problem and its adverse impact on our Nation. The Congress must act because the public demands that we act. Our window of opportunity is a bill endorsed by such otherwise incompatibles on this issue as the Justice Department and myself and the bill's bipartisan sponsors. If we can all agree with the approach taken in S. 1562, then there must surely be hope to pass on to the taxpayers in the fight against fraud.

So, in closing, I urge this subcommittee, Mr. Chairman, to join us in an endorsement of what would truly be an effective step forward. I appreciate your invitation and this opportunity to testify on behalf of this bill and on behalf of the taxpaying citizens of our country.

Thank you to the committee.

[The statement of Senator Grassley follows:]

STATEMENT OF SENATOR CHARLES E. GRASSLEY

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to appear today before this subcommittee to discuss pragmatic reform of our fraud enforcement laws. I commend the Chairman for convening these hearings and for pursuing an appropriate legislative remedy to the growing problem of fraud against the government. I am sure the collective testimony you receive will contribute greatly to the efforts of both Houses to combat fraud and hold accountable those who purloin the Treasury.

Evidence of fraud against the nation's taxpayers is on a steady rise. As with other types of crime and abuses in our society, fraud breeds a culture unto itself. It endures because the opportunity exists and because our ability to counter it is limited by inadequate resources, experience and laws. Recent months have witnessed a proliferation of fraud cases, and yet so few victories by law enforcement officers on behalf of the taxpayers.

No one knows, of course, exactly how much public money is lost to fraud. Estimates from the General Accounting Office, Department of Justice and Inspectors General range from hundreds of millions of dollars to more than 50 billion dollars per year! Sadly, only a fraction of the fraud is reported, and an even smaller fraction of the funds recovered.

The False Claims Act has been the Government's primary weapon against fraud, yet is in desperate need of reform. A review of the current environment is sufficient proof that the Government needs help—lots of help—to adequately protect the Treasury against growing and increasingly sophisticated fraud. The solution calls for a solid partnership between public law enforcers and private taxpayers.

On December 12, the Senate Judiciary Committee voted without objection to favorably report to the full Senate S. 1562, the False Claims Reform Act. This bill, which I sponsored along with Senators DeConcini, Levin, Hatch, Metzenbaum, Cohen, and Leahy, will make necessary reforms in our number one litigative tool against government fraud.

I know this subcommittee is considering several pieces of legislation today which contain various portions of what the Senate Judiciary Committee approved in S. 1562. I would like to submit with my written testimony a copy of S. 1562 as reported.

In hearings before the Administrative Practice and Procedure Subcommittee of the Senate Judiciary Committee, Government and non-Government witnesses offered three general recommendations for more effective enforcement against fraud: (1) increased penalties for more meaningful deterrence; (2) enhanced investigative and litigative tools for better detection and monetary recoveries, and; (3) additional resources to staff the anti-fraud effort.

The False Claims Reform Act incorporates all these suggestions, but without appropriating new funds to any agency. Instead this legislation is intended to complement the Government's current resources by encouraging private individuals to become actively involved in the war against fraud.

S. 1562 promotes a concept first enacted into law by President Abraham Lincoln in 1863. Lincoln's law permits private individuals aware of fraud to bring suit on behalf of the Government and to receive a portion of the recovery if the action is successful.

Through testimony and interviews we have found that most individuals employed by Government contractors are honest and hard-working. Many are also angry and discouraged because they witness and, in some cases, are directed to participate in fraudulent practices. Very few, however, are willing to risk their jobs by "blowing the whistle." Still few believe their disclosures will lead to results of prosecution and conviction.

Pessimism about the likelihood of disclosures leading to results is not surprising in light of a 1981 General Accounting Office report which found among all Government fraud referrals, less than 40 percent were prosecuted. More recently, the Department of Defense Inspector General testified that in 1984 more than 2000 fraud investigations were completed. Yet the Justice Department successfully prosecuted in that same year just 181 cases, including only one against one of the top 100 defense contractor.

In short, S. 1562 would shift the incentives for individuals to come forward by allowing them more involvement in the litigation process as well as increased portions of damage awards. Perhaps most important to persons considering "going public" with this knowledge of fraud are the added legal protections from retaliation due to their disclosures.

The False Claims Reform Act does not create any new federal enforcement bureaucracy. Instead, it is consistent with other areas of law where the Government has inadequate resources to enforce the laws by itself. For example, with securities laws and regulations, the number of private civil enforcement actions far exceeds those brought by the Government. Also, in the antitrust area, private citizens in recent years have been responsible for bringing over 90 percent of all civil enforcement actions.

Mr. Chairman, the public, the Congress and even the Administration all recognize the magnitude of the fraud problem and its adverse impact on our nation. The Congress must act because the public demands that we act. Our window of opportunity is a bill endorsed by such otherwise incompatibles on this issue as the Justice Department and myself and the bill's bipartisan sponsors. If we can all agree with the approach taken in S. 1562, then there must surely be hope to pass on to the taxpayers in the fight against fraud. So, in closing, I urge this Subcommittee, Mr. Chairman, to join us in an endorsement of what would truly be an effective step forward.

I appreciate your invitation and this opportunity to testify on behalf of this bill and on behalf of the taxpaying citizens of our country.

Mr. **Glickman**. Thank you, Chuck.

I know you have to leave. I would just make a couple quick points.

One, I have not dropped a bill in yet. I intend to. But I have not dropped it in yet largely because there were some issues raised in the hearing yesterday, and perhaps today dealing with the administrative side of my proposed bill that concern me a bit; that is relating to how the Administrative Procedure Act would apply to the Defense Department in administrative claims.

It worries me a bit about military folks issuing penalties against civilian volks in a civil fraud context, and I think we need to make sure that there are no problems with that in a legal sense, but I on the whole think that your proposal is excellent. I know that Mr. Berman would agree very strongly with the qui tam provisions of your proposal.

He has been the leader on that issue over here.

But we appreciate the fact that you came over and that you have offered the leadership in this area. I don't think any of this would have moved without you. I don't think there is any question about it.

The final point I would make, is that what you are aiming at is not just Defense—people who do business with the Defense Department, it is people who do business with the Government in general, whether it is the physician using the Medicare system, or a shuttle contractor using NASA, or a defense contractor doing business with the Pentagon because the problem is across the board throughout the whole system of Government.

We are delighted that you came here and we will work with your staff, too, in moving this legislation.

Senator **Grassley**. Thank you.

Mr. **Glickman**. I think he has to go, but if any of my other colleagues want to say something?

Mr. **Berman**. I just join with everything the chairman said regarding your efforts. I think you have done a fabulous job of finally getting Congress to look at updating this law to make, give it some and make it meaningful. I commend you for that.

Senator **Grassley**. Thank you.

Mr. **Glickman**. Mr. Brown.

Mr. **Brown**. No, thank you, Mr. Chairman.

Mr. **Glickman**. Thank you, Chuck.

The next group of witnesses are two colleagues, Andy Ireland from Florida, and Berkley Bedell from Iowa.

Is Berk around?

Mr. **Bedell**. Yes, I am here.

Mr. **Glickman**. You are up.

It is a pleasure to welcome you both here. I know you are both members of the Small Business Committee and I also know that you both have been very actively involved in the whole issue of protecting the taxpayers from fraud by contractors to the Government, so we are just delighted to have you here.

Your entire statements, if you have prepared statements, will be included in the record. You may feel free to summarize or do whatever else you wish.

TESTIMONY OF HON. ANDY IRELAND, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. **Ireland**. My statement is fairly short and I will just run through that and turn it over to Congressman Bedell.

Mr. **Glickman**. OK.

Mr. **Ireland**. Thank you, Mr. Chairman, members of the committee, for the opportunity to appear and discuss the False Claims Act.

Representative Bedell and I have brought this issue to the attention of the Congress as far back as 1983. I am pleased that we now see the matter moving towards a final legislative consideration in both bodies of the Congress, and delighted with the activity of Senator Grassley who just appeared before you.

It is time to recognize that President Abraham Lincoln was on the right track in 1863 when he initiated the process which led to the Federal False Claims Act, and that our predecessors in the Congress during World War II were wrong to have gutted that act.

Let me for the record put in a little history.

The Federal False Claims Act was passed during the Civil War at the behest of President Abraham Lincoln. This followed a congressional investigation which detailed a long list of military contracting horrors. Among them were:

Old and in many cases useless muskets being sold to the Government at eight times their value. The weapons, sold as new, were in fact already Government property; boxes of muskets were opened on the battlefield and were found to contain only sawdust; the same horses were sold to the cavalry twice and sometimes three times—the same was done with cattle and mules; other assorted problems in every area from tent poles to shoes to horse blankets.

The Government Contracts Committee report on the subject written in December 1981 makes for some remarkable reading. Faulty products, nonexistent deliveries and a lack of competitive bidding are often cited as major problems. Here we are 120 years later and we are still confronted with the same problems in military procurement. The problems are far worse now and permeate every area of military and civilian procurement. It truly galls me to see us inundated with expensive tiolet seats, screws, spare parts, coffee pots, et cetera.

This is a tragedy and a smokescreen. While we spin our wheels trying to control the small items at the front door, billion dollar procurements sneak out the back door on the "sole source highway." They are very, very expensive sole sources due to a forced absence of competition and a network of greedy profiteers. In this era of Gramm-Rudman priority setting and runaway deficits, we must get a handle on this problem.

Unfortunately, the teeth of the "Abraham Lincoln Law," as the act in question is referred to, were taken out by congressional amendment during World War II at the behest of military contractors. In any such case today the Justice Department must take over prosecution. I would refer to the problem there, as an aside, to just say that our colleague, Mr. Gonzalez, in March 1982 called the Congress' attention in the Congressional Record to a 60 Minutes report, a public report that in the construction of the shuttle, the Government was being billed for fixed-cost work on the shuttle and for Air Force contracts, the same amount, in other words, being paid for twice.

This was called in a public way to the attention of the public and to my knowledge, I have been unable to find that any followup took place, the Justice Department being the only one who can prosecute under the Abraham Lincoln Law, that could not have gone forward to resolution one way or the other without the Justice Department.

The act requires that the Government must be unaware of any wrongdoing if a prosecution is to be brought. In addition, the amount of award to a private citizen who initially roots out the corruption was severely reduced.

It is obvious that various changes were made in the law to the detriment of the public. The solution is to restore the original Abraham Lincoln Law, with modifications to protect whistleblowers.

In a moment Congressman Bedell will outline what our legislation, H.R. 3828, does. First, I would like to recount a bit of the legislative history of our efforts.

Mr. Bedell and I reintroduced our 1983 bill this Congress and called it the Abraham Lincoln Act Amendments of 1985, H.R. 112. Later we were approached by a member of your distinguished subcommittee—Congressman Berman. He informed us that he had been working with a group, the Los Angeles based Center for Law in the Public Interest. He told us that while he liked our approach, they felt we had overlooked something in our efforts—the risk of the individual who came forward to reveal fraud against the Government. We concurred with their view and the result is H.R. 3828.

We now feel that H.R. 3828 meets our goals in this fashion.

One, it restores the letter and spirit of the original law.

Two, it gives the Government flexibility it does not now have.

And three, it affords needed protection for those with the courage to seek out and expose fraud.

Mr. Chairman, I would be happy with enthusiasm to turn the rest of our performance here over to Congressman Bedell.

Mr. Glickman. I am very delighted to see Congressman Bedell. I see Congressman Bedell an awful lot anyway, but it is a pleasure to see him again.

Berkley, it is a pleasure to have you here.

TESTIMONY OF THE HON. BERKLEY BEDELL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Mr. Bedell. Thank you, Mr. Chairman.

I must apologize for my lateness, I have been to the National Prayer Breakfast and when you are praying for the U.S. Government today, you better spend quite a little time at it.

Mr. Glickman. I was just informed the three-judge panel will in fact rule on Gramm-Rudman so maybe your prayers accelerated that court decision.

Mr. **Bedell.** Thank you.

Mr. **Glickman.** I am not telling you which way I am praying for, however.

Mr. **Bedell.** Well, I want to thank you for the opportunity to be before this panel. I don't know of three people I would rather testify before than all three of you, who really are so sincere in your efforts to do what you can.

I particularly want to thank Mr. Berman for the work he has done, and my friend, Andy Ireland, whose leadership has been of help.

Let me start off by saying that this bill is not perfect. Few pieces of legislation are. We believe the basis that we have here is something that is certainly justified and needs to be done at this time. At least as far as I am concerned, I feel we would like to work with you in whatever way we could to address any problems that you may find as you try to work on the issue.

During the last Congress as many of you know, because of my involvement on the Small Business Committee, I was deeply involved in legislation to do something about Government procurement practice. At least in my opinion, those laws which we succeeded not only in passing but getting signed into law make some very significant contributions toward correcting in some of the problems we have in procurement.

As you know, I am a small businessman and I think I have an opportunity, therefore, to be somewhat aware of how business operates and what business concerns are.

I anticipate that you will probably find some various objections to this rather broad bill. I don't need to tell you, Dan, because I work with you on the Agriculture Committee and you do listen and you do consider those sorts of things. But I hope you objectively look at those objections and be sure they have some relevance.

We heard there are worries of people bringing actions on student loans, but who will bring an action to get only 25 percent of what is recovered, for example? So, look at the reality of the objections that may come forth. Be sure the objections apply to this bill. There is other legislation around. Be sure that objections apply to the bill that we have.

I guess we have to ask why we need to fix anything, what is wrong with the current law?

First, if an individual brings information to the Government and the Government doesn't do anything about it, that individual under current law frequently is just out of luck, and nothing is to be done.

My experience is that there is no part of our Federal Government which we can feel sure that will always do the right thing. At least I believe we need some type of a guarantee, so that if there are problems and if people are aware of them, and the Justice Department refuses to do anything about them, there should be some opportunity for the people of our country to see that something is done. That is really the purpose of this legislation.

I don't want to get into the details, but I have to tell you I have been extremely disappointed with the Justice Department in their refusal to do anything about some major oil companies who in my opinion, are ripping off the Government for billions of dollars on the Alaska pipeline. I have just hit a stone wall and the Justice Department in my opinion refused to look at the issue.

I don't believe any agency necessarily is always going to do the right thing, and this is the purpose of this legislation.

Specifically, what this bill does is it reduces from 6 months to 60 days the time the Government has to decide whether or not to proceed with a suit. The bill contains an out in that, if the court feels the Government should be given extra time, the Government can be given extra time but the Government cannot delay on and on and on. The bill increases the percentage of total damages recovered that is given to the person that brought forth the information that enabled the correction to be made.

It enables the plaintiff, if the Government doesn't act, to go ahead and proceed on his own. I think that is the most important thing of all in this bill. As it is now, if the government doesn't proceed, that is frequently the end of it and tough luck, the person is prevented from taking any action on his own.

The bill also protects plaintiffs or witnesses from being fired or suspended or demoted.

I believe you have to have some protection for whistleblowers, particularly from what we have seen in the past. I think there are some things in the Grassley bill that we probably should look at. As a businessman, I would be greatly concerned if in any way this bill made it possible for disgruntled employees to cause unwarranted difficulty for an employer. I believe that this issue is well addressed by the provisions in the Grassley bill that says that, if a plaintiff brings a suit that is later judged to be frivolous, the plaintiff is stuck with the legal costs. As an individual, I believe that would be a good addition to our legislation.

Thank you.

[The statement of Mr. Bedell follows:]

BEDELL

STATEMENT OF

HON. BERKLEY BEDELL

BEFORE THE

HOUSE JUDICIARY SUBCOMMITTEE ON

ADMINISTRATIVE LAW AND GOVERNMENTAL RELATIONS

FEBRUARY 6, 1986

Mr. Chairman and members of the Subcommittee, I appreciate the opportunity to be with you here today and discuss our efforts to amend the Federal False Claims Act. It's fitting that we are here just a few days before the birthday of Abraham Lincoln, the man who first sought to use informer suits to control government contracting fraud.

I would also like to commend you, Mr. Chairman, for your interest in this legislation and the revolving door legislation on which you held hearings last week. I particularly appeciate your responsible and balanced approach, and I would like to work with you in the same spirit. I would also like to commend Congressman Andy Ireland, who orginally introduced the bill, Congressman Howard Berman, who has made several useful suggestions in the latest version, and Senator Charles Grassley, who has pushed his version through the Senate Judiciary Committee.

Our bill, H.R. 3828, is not perfect. I believe I know generally what needs to be done, but I am not a lawyer and I hope that this subcommittee can use its expertise to help us improve this bill and resolve legitimate concerns. I would be pleased to work with you in this effort.

I think that my background causes me to have a generally balanced approach to this problem. During the last Congress, my Small Business Subcommittee was very involved in the passage of two procurement reform laws, the Procurement Reform Act (PL 98-525) and the Small Business and Federal Procurement Competition Enhancement Act (PL 98-577). I believe that these two laws, and some recent others, go a long way to improving the details of federal procurement procedures. However, my experience leads me to conclude that we cannot legislate common sense or integrity. We must have vigorous enforcement of existing laws. It is apparent that, as in Abraham Lincoln's time, the Justice Department does not have the resources or willpower to do the job. We need a mechanism that encourages informers to come forward.

I am also a small businessman, and understand the dangers in the other direction. We must be careful not to add to the legal burdens of the vast majority of honest business persons who give the government the best product they can at the best price. I hope that provisions can be included in the bill that will discourage frivolous or nuisance suits. Provisions were added during mark-up of the Senate bill that seem to address this problem by putting the burden of legal costs on the plaintiff, in cases where the court rules against the person who brought the suit and also finds that the suit was brought in bad faith.

I might also mention that I think you will two kinds of objections to this rather broad bill. I urge you to listen to the legitimate objections and attempt to modify the bill to meet them. However, if large defense contractors object to the bill on the grounds that informers suits will be brought over student loans, I urge you stick to the bill as it is.

Congress first enacted the False Claims Act in 1863. Few private actions under the False Claims Act were reported prior to the 1940's, and it remained essentially unchanged until 1943. In 1943, the Supreme Court, in *U.S. ex rel. Marcus v. Hess*, 317 U.S. 537, approved a plaintiff's suit based upon the Act. Shortly afterward, at the urging of the Attorney General, Congress gutted the law by removing its teeth, and placing almost all power with the Justice Department. Most of the objections at the time were not valid. The legitimate objection raised at the time was that the law might allow unwanted suits by professional "bounty hunters." Our bill would address this problem by clarifying the original law as passed in 1863.

What is wrong with the present law? First, when a citizen files a suit alleging fraud, all of his evidence is presented to the government. The government then has 60 days to enter an appearance and then 6 months more to decide whether to proceed. If the government decides to proceed, the citizen is then out of the case and the government can proceed (or not proceed) as it sees fit.

Second, if the government decides not to proceed, the court can still dismiss an action brought by a private citizen if the case is based upon "evidence or information the government had when the action was brought." Clearly, it would be difficult to find a case where evidence is not somewhere in the hands of some government official, even if the government did not have the evidence in organized form or even know it had it.

Third, the amount of awards for a private citizen are now 10 percent of the total damages recovered if the government proceeds and wins, and 25 percent of the total if the citizen proceeds and wins. The amounts used to be 25 percent and 50 percent.

Fourth, in every case, the law provides that the citizen "may" collect a reward, and leaves the decision completely to the court. Obviously, this greatly discourages persons from coming forward.

Our bill addresses these problems by--

--reducing from 6 months to 60 days the time the government has to decide whether to proceed with a suit;

--changing the law to say that the successful plaintiff "shall" collect a reward (not "may");

--increasing the percentages of total damages recovered that would be given to the informer bringing the suit;

--allowing the plaintiff to maintain his or her involvement in a suit after the government enters the case, to make sure that the case is effectively prosecuted;

--prevents a suit from being dismissed soley on the government's assertion that it already had the information brought forward by the plaintiff (although our bill does require that a private citizen cannot simply come forward with information that the government has already used in a public proceeding); and

--protects plaintiffs and witnesses from being fired, harassed, suspended or demoted.

Regarding protection for whistleblowers, we feel strongly that we must have some protection for these people who courageously risk their livelihoods. In combination with the provisions discouraging harassment suits by citizens, this should ensure that we get the information we need without burdening businesses.

Mr. Glickman. I want to thank you both for your discussion. Certainly most of the provisions in your legislation will be included in bill that I will introduce myself. It is my judgment, it is—if we move ahead with the bill through markup, will try to move ahead with the bill that is more comprehensive than just the issues you raise in your legislation, including consideration of the whole program fraud civil penalties proposal and other things as well.

But I sense that there is momentum to move in this area and it has largely been through your efforts here on the House floor that the issue has gone this far. We want to do a reasonably balanced job but we want to do a job that is effective so people have confidence that their Government is not getting ripped off, as you say most people are not ripping the Government off but there are a few that are, and we need to deal with those.

So, we will proceed to go into some greater detail as to the specifics as we get later witnesses today. You probably ought to look at the Justice Department testimony if you have not seen that, because it goes into a little depth. They support most of the things except they don't support the qui tam provisions that you have talked about in your testimony.

But I think we are going to move forward here, and I appreciate your testifying before us.

Mr. Bedell. We would be wrong if we didn't give credit to Howard Berman in what he has done in getting this thing moving.

Mr. Ireland. Absolutely, yes.

Mr. Glickman. Surely.

Mr. Kindness.

Mr. Kindness. Thank you, Mr. Chairman.

I apologize for not being here earlier. I left another hearing in which Mr. Ireland testified earlier, so we are following each other around.

Mr. Ireland. Absolutely, yes.

Mr. Kindness. I will have to return to that one, too, but would like to thank both of you gentlemen for your interest and concern in this area.

I would ask you to think about one thing and I would be interested to know your responses if you have them now, but later, perhaps, if you need to do some checking.

Mr. Kindness. I wonder if either of you have had, as I have had, a local housing authority, which is a quasi-governmental body, experience a difference of opinion with the Department of Housing and Urban Development over how much rent subsidies they were entitled to during the period of years when interest rates went up and they had higher income from the interest on their investment of idle funds during that period of time than they had projected, and then in some cases, perhaps, costs were projected higher than they turned out to be.

And I know I have one case like this, and if some of the ideas that are incorporated in bills before us now had been in force at the time, I think it is conceivable that HUD could have brought their claims under this type of legislation to recover moneys that had been paid to quite a number of local housing authorities like this around the country.

It was a common problem and in fact those housing authorities had tended to rely in most cases upon clearing their budgets with the local front offices but then later HUD was claiming in effect that they practically fraudulently had submitted budgets that didn't project their income from interest on idle funds as high as it should have been and so on.

I know Mr. Bedell was talking about not expecting the qui tam provisions involving student loan cases and so on, but I submit to you there could be cases like this where the qui tam provisions could perhaps come into play. And I am not sure of whether it would be a good thing to have it apply in cases like that where you have a local governmental or quasi-governmental body.

Consider also cities receiving grants of one sort or another from the Federal Government, representations made, statements made in writing in applying for grants or loans and the potential for parties to be made defendants in such actions.

I would invite any response you have at this point but I am wondering is there some kind of carve-out that ought to be considered so you don't include local governments or quasi-governmental bodies in the coverage of such legislation?

Mr. **Bedell**. My opinion is that the purpose of this legislation is, as far as I am concerned, to see there is not major fraud perpetrated against the Government. I think your question concerns organizations that serve the Government, not the Government itself.

Now, I assume that, neither of us would approve of fraud by a local governmental entity as it works with the Federal Government. But that is not really the primary issue, at least as far as I am concerned, that we are trying to get at in this bill.

Mr. **Ireland**. No.

Mr. **Bedell**. At least I for one would have no objection in considering changes in the bill that addressed the legitimate concerns of governmental In fact, I think the bill does this to a great extent. It ought to be intentional fraud that we are after.

Mr. **Kindness**. That is the problem you see. It is not requiring intentional fraud. These bills generally go in the direction of removing the need for the prosecutor to prove intent or any state of mind.

Mr. **Bedell**. That was not my understanding. My understanding is that your bill merely clarifies the definition of "knowingly" to be used in these civil actions. The penalties of the False Claims Act are civil, and the standards of proof should reflect this. Certainly, what we are looking for is the case where people supplying the Government are ripping off the Federal Government.

I don't need to tell you, Tom, that that is occurring. I think there has been a lot of awareness of the problem think as you bring awareness, you have less of the problem. I do not think that we want to get into a situation where local governments are being sued as they try to do their job as best they can, if that is your question.

Mr. **Ireland**. I concur in that.

Mr. **Bedell**. I am just speaking for myself on that.

Mr. Ireland. The point is to get to the real fraud that is intentional and separate that from it.

I think Mr. Bedell and I are very strongly behind that thrust and that is why we are here today, to want to work for making the legislation do that without bringing in the unintentional parties.

Mr. Kindness. I would just urge consideration of—in fact, the language in H.R. 3828, your bill, Mr. Ireland, defining the term "knowing" and "knowingly," for purposes of this section, the terms "knowing" and "knowingly" mean the defendant, *A* had actual knowledge, or, *B* had constructive knowledge in that the defendant acted in reckless disregard of the truth and no proof of intent to defraud or proof of any other element of a claim for fraud at common law is required.

I am wondering whether we really have been talking about our general concept of common law fraud in discussing this subject. When you get to specifics like the local governmental unit, for example, I'm sure you do want to eliminate actual fraud but perhaps not with the kind of definition of knowledge or knowingly that we have here.

Mr. Ireland. At the same time we can't leave an open door in our willingness to do that and certainly we are willing to work along that line in the legislation. But to leave it open so they drive the truck of the out-and-out fraud that we know goes on through it. So that we have to address and find the balance to that.

Mr. Kindness. Of course, we have ways of recovering. In the cases I was just talking about, HUD has recovered through lowering the amount of payments for rent subsidies that those housing authorities would otherwise be entitled to under the law over a period of 2, 3, 4 years, in some cases.

There is no fraud involved in the common law sense. Not at all. But estimates are estimates and they are always inaccurate to some degree.

After the fact you can reassess them and that is the kind of case we don't seem to want to get at in this legislation.

Mr. Ireland. That is right.

Mr. Bedell. Would the gentleman yield?

Mr. Kindness. Sure.

Mr. Bedell. I am not a lawyer, but it seems to me knowingly is knowingly and knowingly says you knew it. It seems to me that the bill's language defines what knowingly means. That is our intent.

If you knowingly do something, you did it because you knew it. Now, it does not mean that you had to do it with this in mind or that in mind. This is the definition.

I don't think that is really the critical issue. The critical issue is what we are trying to do. What we are really trying to do here is to say that, if the government does not properly protect the people in the way it enforces the laws, there will be a chance in civil court for individuals to see that justice is done.

It seems to me that if we control it properly, this mechanism is a heck of a good thing, particularly in view, if I might be so bold as to say, of some of the experiences I have had as I have tried to deal with some people in the Justice Department. I don't think that they are greatly different from people in any other department.

I think they are not always going to do their job the way it ought to be done. If we can have some system that will let the people know that there is a stopgap, it seems to me that that is a good thing for us to do.

Mr. **Ireland**. If I may interject.

Mr. **Bedell**. Sure.

Mr. **Ireland**. This turns loose a resource in this country that needs to be turned loose and that is the American people and——

Mr. **Kindness**. I don't disagree with that concept at all.

Mr. **Ireland**. It can do the job.

Mr. **Bedell**. I think you can find a million reasons why you shouldn't do it. I don't think anything was ever proposed where people couldn't find a million reasons why you shouldn't do it.

I think the issue is, what are the things we ought to change in order to do it right as we do it?

Mr. **Kindness**. Yes, and that is the reason I wanted to explore these things with you.

I am harboring the concern, for example, that we ought not to pass such legislation out of this subcommittee that affects applicants for grants, even individuals perhaps, and loans. Perhaps there is a good bit we ought to carve out of it because what brings this to a head is we are talking about government contracts primarily; this is where all the emotion is centered. That seems to be what we are kind of trying to fix and maybe we ought to center it on just that.

I encourage any comments along those lines.

Mr. **Bedell**. We do not disagree.

Mr. **Ireland**. We don't disagree basically.

Mr. **Kindness**. Thank you.

Mr. **Glickman**. Mr. Brown.

Mr. **Brown**. Thank you, Mr. Chairman. No questions.

Mr. **Glickman**. We thank you both for being here and we will keep in touch with you and your staffs as this issue progresses, as I am sure it will.

Mr. **Bedell**. Thank you.

Mr. **Ireland**. Thank you, Mr. Chairman.

Mr. **Glickman**. Thanks a lot.

OK, the next witness is Mr. John Michael Gravitt, who is accompanied by his attorney, Mr. James B. Helmer.

TESTIMONY OF JOHN M. GRAVITT, ACCOMPANIED BY JAMES B. HELMER

Mr. **Glickman**. We are most appreciative, Mr. Gravitt, that you are here today.

I must warn you in advance that the House goes in at 11 so it is possible we may have votes right away and we are not being intentionally rude, only institutionally rude in that we may have to leave for a few moments to go out and vote.

Why don't you go ahead and proceed. Your entire statements of both of you will appear in the record. You may proceed as you wish.

We would like to give you as much time for questions so we hope you can govern your formal presentation accordingly. Thank you very much.

Mr. **Gravitt**. My name is John Michael Gravitt, and I am a 46-year-old tool room machinist foreman employed by the Ford Motor Co. in Batavia, OH, near Cincinnati.

I am here today to talk to you about my experiences with the False Claims Act, including the lawsuit which I have brought alleging a multimillion dollar fraud scheme by General Electric Co.

I was formerly employed at the General Electric Co., Aircraft Engine Business Group, Evandale plant, in Evendale, OH 45215. This plant is located in the suburbs of Cincinnati, OH, in Hamilton County, and employs approximately 17,000 people. I worked for General Electric from June 23, 1980, until June 30, 1983.

I was first employedas a machinist, but because of my skills and many years of prior experience as a machinist, I was soon promoted to a machinist foreman in developmental manufacturing operations, then called DMO and later changed to component manufacturing operations.

As a machinist, I set up and operated various machine tools. After promotion to the foreman position, I supervised 18 to 30 machinists. Also, I supervised some inspectors, laborers, and toolmakers.

My work as a supervisor was to assign jobs to each employee, determine that time cards and vouchers were accurate and correct, and to try and expedite work by making sure that the proper tools, fixtures, and gauges, et cetera, were available and in working order so that my employees were productively occupied.

General Electric used vouchers to charge the work performed by each employee to the proper account or customer. In my shop, we worked on both commercial and U.S. Government defense contracts.

In my work as a foreman, I was instructed, along with at least one other foreman and probably others, to alter my hourly employees' time vouchers. The changed vouchers were supposed to reflect that all time spent by employees under my supervision on their 8-hour shifts was time spent on specific Government jobs, regardless of whether the machinist had been idle because he was waiting for an engineer, waiting for parts, or did not have work to be done.

As a result, the Government was being charged for time that was not being spent by employees on Government contract work.

I was also instructed, usually on a weekly basis, by means of a hot sheet that certain commercial jobs and fixed-cost Government jobs were already in a cost overrun situation, and that no employee time was to be charged to these hot-sheet jobs.

As it turned out, the only jobs that this time could be charged to were developmental U.S. Government defense contracts. These contacts, to the best of my knowledge, were all cost-plus contracts.

So the more time that was billed to these cost-plus contracts, the more money General Electric made as a result of the false vouchers.

Eventually, I think I finally figured out the system that was being used to defraud the Government. I talked with my supervisors about what I had observed, but I received no response.

I continued to refuse to falsify and change vouchers. I discovered, however, that if I did not change the vouchers, my supervisors would. My opposition to the voucher falsification was well known by my supervisors, other members of management, and hourly personnel. In fact, I believe I was fired from GE because of my objections to falsifying vouchers.

In the spring of 1983, I was told I was going to be laid off due to so-called lack of work. This lack of work period was the same time that General Electric received the B-1B bomber contract.

In late June 1983, about the same time as my last day of work, with my wife's assistance, I wrote to Brian H. Rowe, executive vice president of the General Electric Co., the top GE executive at Evendale, to report the false vouchers.

Eventually, Mr. Rowe's office, not Mr. Rowe himself, but his secretary, put me in contact with an internal company auditor. This was a Mr. Duroucher, who within the last 6 months has been elected vice president of General Electric.

He put me in contact with a Mr. R.G. Gavigan. After his internal investigation, Mr. Gavigan told me 80 percent of my allegations had been proven true, and the remaining 20 percent could not be disproven. That was the last I heard from General Electric regarding the falsified vouchers until my lawsuit was filed.

Based upon what my wife, who is still employed at General Electric, and other current GE employees tell me, I have observed not any real change in the vouchering procedures, nor am I aware of any meaningful disciplinary action taken against anyone involved.

In fact, my former supervisor , Mr. William Taylor, who was one of the persons who told me to falsify vouchers, has recently been promoted. Mr. Taylor's current job requires him to answer a special telephone voucher hotline. Any employees who have questions on how to properly complete their vouchers are now encouraged by GE to call Mr. Bill Taylor and obtain proper instructions. The phone number is area code 513-243-2011.

I brought my False Claims Act lawsuit because I was not satisfied that General Electric had corrected its false vouchering practices. I did not take on this litigation lightly, and it is extremely risky for me. As you know, I am here testifying today at my own expense. Under the statute as it now exists, I can only obtain a maximum of 10 percent of the amount recovered for the government as a result of my lawsuit, because the U.S. attorney has entered an appearance in my case, and claims to have taken it over. The Government's attorneys, however, have done little but ask for extensions of time in this case.

My wife has also risked her job, and except that she is represented by a union, GE probably would have fired her, because of her relationship to me, and her assistance to me in bringing this lawsuit and this matter to the government's attention. There is no law which would prohibit General Electric from firing her for these reasons. Thus, I believe it is important that whistle-blowing employees like myself have lawful protection against being fired by contractors who are defrauding the Government. While such a law would be too late for me, it would certainly help other employees.

My main purpose in bringing this lawsuit was to force GE to stop overcharging the taxpayers. I am very concerned that my case does not seem to be moving along. The Justice Department has done no civil investigation in my case, and the Justice Department lawyers who are responsible for it have not looked at any of the evidence involved in the criminal investigation which occurred.

The Justice Department has just taken GE at its word that while there was some inaccurate vouchering, it did not involve much, if any, of a net dollar loss to the government, so I strongly support any changes in the law that would allow me and my attorney to be actively involved to fully investigate this case, to bring it to trial, and put an end to this multimillion-dollar fraud scheme.

I thank you very much for inviting me here today. My wife, Marlene Gravitt, also took time off from work to be here today. We offer whatever assistance you think appropriate in your further considerations of amendments to the False Claims Act.

[The statement of Mr. Gravitt follows:]

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ADMINISTRATIVE
LAW AND GOVERNMENTAL RELATIONS

TESTIMONY OF JOHN MICHAEL GRAVITT
FEBRUARY 6, 1986

My name is John Michael Gravitt and I reside at 6305 Orchard Lane, Cincinnati, Ohio 45213. I am 45 years old and am currently employed as a foreman by the Ford Motor Company. I am married and have two children.

I am here today to talk to you about my experiences with the False Claims Act, including the lawsuit which I have brought alleging a multi-million dollar fraud scheme by General Electric Company. My lawsuit is currently pending before Chief Judge Carl B. Rubin in the United States District Court for the Southern District of Ohio. Part of my lawsuit is also before the United States Court of Appeals for the Sixth Circuit, as my lawyer, James B. Helmer, Jr., who is here with me today and will also give testimony, will explain more fully to you.

I was formerly employed at the General Electric Company, Aircraft Engine Business Group, Evendale Plant, Interstate 75 and Newman Way, Evendale, Ohio 45215. This Plant is located in the suburbs of Cincinnati, Ohio in Hamilton County and employs approximately 17,000 people. I worked for General Electric from June 23, 1980 until June 30, 1983.

I was first employed as a machinist, but because of my skills and many years of prior experience as a machinist, I was soon promoted to a machinist foreman in Developmental Manufacturing Operations, then called "DMO" and later changed to Component Manufacturing Operations.

As a machinist, I set up and operated various machine tools. After promotion to the foreman position, I supervised 18 - 30 machinists. Also, I supervised some inspectors, laborers, and tool makers. My work as a supervisor was to assign jobs to each employee, determine that time cards and vouchers were accurate and correct, and to try and expedite work by making sure that the proper tools, fixtures, and gauges, etc. were available and in working order so that my employees were productively occupied.

General Electric used vouchers to charge the work performed by each employee to the proper account or customer. In my shop, we worked on both commercial and United States Government defense contracts. Particularly, we worked on engine parts for the B-1 bomber, the NASA "E^3" energy efficient engine, the nozzle of the F-404 aircraft engine, and other United States Government contracts. In my work as a foreman, I was instructed, along with at least one other foreman and probably others, to alter my hourly employees' time vouchers. The changed vouchers were supposed to reflect that all time spent by the employees under my supervision on their eight-hour shifts was time spent on specific Government jobs, regardless of whether the machinist had been idle because he was waiting for an engineer, waiting for parts, or did not have work to be done. As a result, the Government was being charged for time that was not being spent by employees on Government contract work.

I was also instructed, usually on a weekly basis, by means of a "hot sheet" that certain commercial jobs and fixed-cost Government jobs were already in a cost overrun situation. My supervisors did not want us to charge any employee time to these jobs that were in cost overrun situations as indicated on the "hot sheet."

The vouchers were not supposed to show "idle" time and were not supposed to show time charged to jobs that were in a cost overrun situation and that were on the "hot sheet" and were, of course, not to show time charged to other commercial contracts. Practically the only category of job left upon which time could be charged in the vouchers for these cost overrun contracts were "re-work and modification" jobs which were basically developmental United States governmental defense contracts. These contracts, to the best of my knowledge, were all "cost-plus contracts" so that the more time that was billed to them, the more money General Electric made as a result of these contracts.

I also observed further fraud and waste at General Electric relating to defense contract work because often too many employees were working in my department, so that there was not enough work to keep everyone busy. So, I would have to put two machinists on one machine, but their time was charged to the Government as if work was actually being done by two men on two separate machines.

After a period of time observing how things worked, I believe I finally figured out the system and the method that was being used to defraud the Government. I talked with my supervisors, with other foremen on the job, and others. I received no response. I refused to falsify and change vouchers. But, I discovered that even if I did not change the vouchers, my supervisor would so that Government was charged improperly for time. Sometimes my supervisor completely substituted vouchers in order to charge time to the Government. Occasionally I would be told that vouchers had turned up "missing." Rather than let me go back and review the records for those days to try and reconstruct what work had been done, my supervisors ordered me to fill in certain job numbers -- I think that they were always Government job numbers.

My opposition to the voucher falsification was well known by my supervisors. But, I got no meaningful response from them when I complained about this fraud. Instead, I believe that G.E. fired me because of my objections to the false vouchers. In the spring of 1983, I was told I was going to be laid off due to a so-called "lack of work." About the same time, my wife, also employed as a machinist at General Electric, and I began putting together the information regarding falsification and changing vouchers. In late June 1983, about the same time as my last day of work, I wrote to Brian H. Rowe, Executive Vice President of General Electric Company, the top G.E. executive at Evendale, reporting the false vouchers. I tried to talk with Mr. Rowe and after a number of telephone calls, his secretary told me he had read my letter and that an internal auditor would investigate it. I eventually met with the company auditor, Mr. R. G. Gavigan. He suggested a meeting at a restaurant not on G.E. property. After the end of the investigation in September 1983, Mr. Gavigan called me and told me that 80% of my allegations had been proven to be true and the other 20% could not be disproven. That was the last time I heard from General Electric regarding the falsified vouchers until my lawsuit was filed.

BEST COP BLE

As my wife remains employed at G.E., I am aware of the current vouchering system. Based upon what my wife has told me and what other current G.E. employees tell me, I believe that no real change in the voucher procedures have resulted from that investigation, nor or am I aware of any real disciplinary action against anyone involved.

In fact, my former supervisor, Mr. William Taylor, who was one of the persons who told me to falsify vouchers, subsequently has been promoted since my lawsuit was filed. One of Mr. Taylor's newest job duties is to answer a special G.E. telephone, a voucher "hotline". Any employees who have questions on how to complete vouchers are now encouraged by G.E. to call Mr. Taylor and get all the "explanation" they need.

Because I was not satisfied by Mr. Gavigan's investigation and because it appeared that G.E. had not done anything to correct the false vouchering practices, I consulted an attorney about what I had seen at General Electric Company. As a taxpayer, I thought something should be done so that the Government did not continue to be overcharged millions of dollars by G.E. My attorney, Mr. James B. Helmer, Jr., who is here with me today, shared my concern. Eventually, after considering several options and thinking about the impact such a lawsuit would have on my personal life, I filed my False Acts Claims case in October 1984.

This case is an extremely risky proposition for me. In order for me to even have the expenses of the court case paid, my case must be successful. As you probably know, I am here testifying today at my own expense.

The Federal District Court in Cincinnati and Chief Judge Carl B. Rubin have complete discretion to determine how much, if any, compensation I receive for bringing this matter to the United States Government's attention. Right now, the statute provides that I can only obtain a maximum of ten percent of the amount recovered for the Government because the United States has entered an appearance in the case and claims to have taken it over. As my lawyer will explain to you, the United States Government has done very little, if anything, to investigate the fraud I have alleged in my lawsuit. Out of any money I recover in bringing this case to the Government's attention, I have an obligation to pay my lawyer for his services. In addition, my out-of-pocket expenses have been about a hundred dollars a month, but Mr. Helmer tells me that if the Justice Department or Chief Judge Rubin allows me to be more actively involved in the case, my expenses could easily be thousands of dollars a month. That figure only represents the costs of this case. It will not pay my attorney for his time and efforts.

Personally, I have invested hundred of hours of time in this case. My wife has been very involved in this case also, even though it could jeopardize her job at G.E. In fact, except for the fact that she is represented by a union, General Electric could have fired her because of her relationship to me and her assistance in bringing this matter to the Government's attention, without fear of any legal penalty.

My wife Marlene and I have received many phone calls and other inquiries from present and former G.E. employees who have reported similar experiences. While I am the only one who has brought False Claims Act case against General Electric Company, it appears to me that a lot of other people who worked at G.E. have been very concerned about the fraudulent practices they observed.

It is important that the United States Government make the False Claim Act law stronger. If the law was stronger, it would be used more and more lawyers and employees of Government contractors would be aware of it. "Whistle-blowers" like myself would also have protection from losing their jobs. While this protection would be too late to help me, it would protect the other employees who have reported fraudulent practices to me and my lawyer.

I also support the proposed changes that help make sure that if my lawsuit is successful, that I would receive some compensation for my efforts for sticking my neck out. If it was not for the fact that my wife and I are both employed with steady work, we could not have taken on the financial and time demands of this lawsuit. As it is, we have taken on a considerable financial risk with no assurance that our efforts will be compensated. Also, I believe it is good that the proposed legislation creates a minimum compensation for whistleblowers who bring fraud False Claims Act cases and gives the Judge more discretion to determine the appropriate amount of compensation for False Claims Act plaintiffs, depending upon the contribution that has been made. This seems to be a fair provision that insures that no one will be overly compensated, but that each False Claims Act plaintiff will be fairly compensated.

My main purpose in bringing this lawsuit was to force G.E. to stop overcharging the taxpayers and the United States Government. I am very concerned that my case is not now moving forward. The current law prohibits me and my attorney from being actively involved in the case. The Department of Justice has done no civil investigation of my case. The civil Department of Justice lawyers have not looked at any of the evidence involved in the criminal investigation. They have just taken G.E.'s "word" that while there was some inaccurate vouchering, it did not involve much, if any, of a net loss to the Government. So, I strongly support changes in the law that would allow me and my attorney to be actively involved to fully investigate this case, bring it to trial, and put an end to this multi-million dollar fraud scheme.

I thank you very much for inviting me here today to testify and I offer whatever assistance you think is appropriate in your further consideration of amendments to the False Claims Act.

Mr. Glickman. Mr. Gravitt, I want to thank you very much. I not only appreciate the importance of your saving the taxpayers dollars for fraudulent expenses, but also your willingness to travel here today at your own expense. I want to state for the record that under ordinary circumstances this committee would have paid your expenses here today, but because of the uncertainty regarding the current budget situation as it affects the Gramm-Rudman amendment, we were put on freeze and on hold to pay any travel expenses at all.

That may be lifted, it may not be lifted, we don't know right now, so the fact that you would come up here when you would have to pay for this out of your own pocket is extraordinary, and it is something that you deserve special recognition for. I think your attorney is with you, Mr. Helmer.

Mr. Helmer, I think you also have a statement.

Mr. Helmer. Thank you, Mr. Chairman. I appreciate the opportunity to address this panel this morning. My name is Jim Helmer. I am an attorney licensed to practice in Ohio and in the District of Columbia, and I specialize in federal litigation, which means that I spend most of my time trying to define the intent of this body and the U.S. Senate in carrying out the laws that have been enacted, in trying to enforce those laws.

I want to echo the comments that Mr. Gravitt has made to a large extent, and I would like to, if I may, point out to you what exactly has happened with Mr. Gravitt's qui tam action and the position taken in that case by the U.S. Justice Department, because I think you will find it to be 180 degrees from the position espoused to this panel in testimony delivered by the Justice Department representatives yesterday.

Before I do that, I would just like to point out a couple of additional items about Mr. Gravitt's background. He is not only a concerned citizen, but he is a combat veteran of Vietnam, decorated in that conflict, served two tours there. He is very concerned about the defense industry and about the problems that face it.

As he said, he has not taken on this litigation lightly. This is not a bounty-hunter's lawsuit. It is not a parasitical lawsuit. It is not a lawsuit involving student loans. It is a case against the third largest corporation in the United States, and one of this country's largest defense contractors.

Part of my work as an attorney, and the reason that Mr. Gravitt came to see me in the first place, is because I specialize in representing employees who have been wrongfully discharged from their employment. That involves using the Federal age discrimination statutes, title 7 of the Civil Rights Act and various other statutes that have been passed in Ohio to protect employees that are in certain categories.

When we first met with Mr. Gravitt and talked with him, we learned that there is no statute either in the United States or in the State of Ohio that protects a whistle-blower from doing what Mr. Gravitt has done. Ohio, like many states, recognizes the employment-at-will doctrine, which permits an employer to discharge an employee at any time for any reason.

Accordingly, we think that it is imperative that this body give consideration to protecting a citizen, an employee wh comes forward and brings information either to the authorities, to the company management, or to the courts, or even to this body, from discharge from their employment. As I say, there is no such protection anywhere now, and unless this False Claims Act is amended, you are not going to encourage the support that I believe you need from the citizens to ferret out defense contracting fraud.

Mr. Gravitt's case was brought in October 1984. With the complaint, we filed massive discovery requests. We noticed the depositions of Mr. Brian Rowe, the vice president of General Electric who is in charge of the 17,000 employees at General Electric in Evandale, along with noticing the deposition of the investigator. Prior to the time that those depositions were to go forward, and prior to the time that the discovery responses were to be answered, the Justice Department intervened in Mr. Gravitt's case, pursuant to the qui tam provisions and took the case over.

The first thing the Justice Department did on the very day that it intervened was to stay all discovery. They put a stop on all discovery that had been started. They immediately asked Judge Carl Rubin, who had been assigned the case, to provide them with the stay from conducting any other discovery, which the judge did grant them for a period of 90 days. At the end of the 90 days the Justice Department asked for a second stay of 90 days, which it also received. At the end of that 90-day period, the Justice Department asked for a third stay of all proceedings in the civil case, and this time Judge Rubin said no, the case is going to go to trial.

In the interim while the stays were asked for, the civil side of the Justice Department did no investigation. Instead the criminal side, which is separated by essentially a Chinese wall, they are not permitted to discuss cases with each other or share information, because of the Federal Rules of Criminal Procedure dealing with the sharing of criminal investigative material, the criminal side did conduct an investigation, and we have been informed of the results of that investigation by members of the FBI and the Justice Department.

What the investigation showed was exactly what Mr. Gravitt has said: that his allegations were proven. They did, in fact, occur. The falsified vouchers were not on a small scale, but involved thousands and thousands of time vouchers over a 3-year period.

The Justice Department's criminal investigators took a sampling of 6 months of the 3-year period that Mr. Gravitt worked at General Electric, and looked at just the vouchers in the one department that he worked at. In that 3-year period, there were 75,000 time vouchers produced by employees at General Electric in that one department. The Government investigators looked at approximately 10,000 of the time vouchers. They concluded that 3,000 to 4,000 of the 10,000 vouchers they looked at had, in fact, been altered, had, in fact, been falsified.

I have brought some of those vouchers with me today that I would like to attach to my testimony, because, I think, you will see that there was nothing subtle about the altering. They just took the numbers that had been written by the employees who did the work, and simply took a darker pen and wrote new numbers over the top of the old numbers. You can still read the numbers underneath. You can still read the numbers on top, and if you understand the contracting process, you can see the change from commercial work to Government contract work. This happened, according to the investigation, to some 3,000 or 4,000 of the 10,000 vouchers looked at.

Now, if you extrapolate that over the 3-year period, and the Justice Department tells us this study was a good study and you can do that, you get some 18,000 or so falsified vouchers in this three-year period.

The Justice Department decided not to criminally prosecute General Electric, principally because—at least this is my understanding—they did not believe they could prove any damages resulting from this fraudulent scheme. The civil side, having been instructed by Judge Rubin to go forward with Mr. Gravitt's qui tam suit, then sat down with General Electric and worked out a settlement of the qui tam action.

Now, the civil side, you must remember, took no depositions, interviewed no witnesses, did not talk with Mr. Rowe or any of the investigators, did not have access to the information that the criminal side had, because of this Chinese wall created by the rules. There is a way to get that information. The civil side can get it. They have to file a motion asking the district court to release that information, which was never filed.

Despite the fact that the civil side had no information to base its conclusion concerning Mr. Gravitt's qui tam action, it entered into a settlement with General Electric for the sum of $234,000, concerning his claims.

I received a telephone call in early November from representatives of the Justice Department here in Washington, to explain this settlement to me. During that call, I was informed that Mr. Gravitt, as a person who brought this action to the United States' attention, would be entitled to receive $23,400 for his efforts under the present qui tam action, and I was told that the Justice Department would make sure that happened, unless Mr. Gravitt objected in any fashion to the appropriateness of the settlement itself, and I was then told that if he did so object, that the Justice Department would make sure that he never saw a nickel for his efforts in this case.

When I informed the representatives of the Justice Department that that threat would have to be reported to Judge Rubin who was hearing the civil case, I was then informed that if I did so, I would be sanctioned by the Justice Department. There was a face-to-face meeting 2 days later with the representatives of the Justice Department. Mr. Gravitt and his wife and another attorney in my office, a special investigator from the FBI and an auditor from the Defense Contract Auditing Agency were presented where those threats were again repeated, this time to the entire group. The threats were, in fact, made known to Judge Rubin 2 days later at a chambers conference, and they have been submitted on the record.

Thereafter, the Justice Department carried out its threat, and took the position despite what they told you yesterday, that a citizen who brings one of these suits is not a proper relator when the Government gets involved if the Government can point to anything that it knew about prior to the relator bringing the suit, and that, therefore, not only does Mr. Gravitt have no right to participate in the qui tam action, but that Judge Rubin himself has no right to consider the fairness of the settlement.

Now, the result of that position, and the attack on the jurisdiction of the U.S. district court, is that the Justice Department is saying once we get involved in a case, there is to be no court supervision of a settlement; whether it is a good settlement, a bad settlement, it is not to concern anybody but the U.S. Justice Department.

Mr. **GLICKMAN**. All of this is happening this past November, right?

Mr. **HELMER**. This has all happened in November and December 1985, that is correct.

Mr. **GLICKMAN**. Just a couple of months ago.

Mr. **HELMER**. Yes.

Now, the problem with that position—and, I think, it is a problem that is addressed in the bill that Mr. Berman is cosponsoring—is that it allows a sweetheart deal to be worked out between the Government and the contractor, with no participation in this case by the whistleblower, the man who knows the most about the fraud, who, by the way, was never called to testify before a grand jury, has never been deposed himself, or the other foremen who support his testimony.

Why is the $234,000 amount inadequate? Under the present law, for every false voucher that has been submitted, whether you can show any damage or not, the statute says that there is a $2,000 forfeiture or penalty that can be imposed. Now, if you have 3,000 false vouchers, that is $6 million in penalties. If you have 18,000 false vouchers, which the study would indicate you have had in this particular case, you have a $36 million forfeiture, as compared with the $234,000 that the Government is attempting to settle this claim for.

Now, before you say, well, that is farfetched, that is exactly the formula that the U.S. Justice Department applied in Philadelphia in the late spring of 1985 against the identical defense contractor.

General Electric, for the identical type of claims, misvouchering of timecards. The Government applied a $2,000 per misvouchered timecard penalty.

Mr. **Glickman**. How many were there in that case?

Mr. **Helmer**. In that case the indictment that was returned included, I think, 104 timecards, so the penalty was not quite $1 million, but it was a very substantial penalty.

My point is that the law has not changed in that 6-month period from when the General Electric Co. misvouchered timecards in Philadelphia, and when they were caught doing it in Cincinnnati, but I will tell you what the big difference between the two cases is, and the only difference. In Philadelphia the Justice Department brought the case by themselves. In Cincinnati, a citizen through the qui tam provisions, brought the matter to the Justice Department's attention.

Now one more point on this I would like to make about the Justice Department's role. They told you yesterday that it is their view that a qui tam plaintiff's proper role would be to present an objection to any settlement that is made that the qui tam plaintiff doesn't believe is appropriate. That position, despite you having been told that yesterday, is not the position that the Justice Department is taking in Cincinnati, OH, and in the U.S. Court of Appeals for the Sixth Circuit concerning Mr. Gravitt's case right today.

The Justice Department is taking the position in Cincinnati that Mr. Gravitt should not be permitted to be heard or participate in any manner in this settlement, and further, that the U.S. district court should not be permitted to be heard or to participate in any manner in this settlement.

Judge Rubin's view, simply stated, was who guards the guardians. The Justice Department is the guardian of the Treasury. Fine. Well, who guards the guardians? And if a citizen has information, if a citizen has evidence to submit that a settlement is not fair and not in the interest of all of the taxpayers, how can that citizen present that information.

The reason I have gone into the detail to explain to you these procedural problems that have come up is because, I think, all of these are specifically addressed in the bill that Mr. Berman is cosponsoring, and that if that bill were, in fact, the law today, none of these problems would exist. We would have protection for Mr. Gravitt losing his job. We would have a role to play for the qui tam plaintiff, even though the Justice Department has intervened in the case. We would have the opportunity for the qui tam plaintiff to make his views known to the Federal court. Is it a fair settlement or is it not.

It is not our role to decide that. That is the judge's role, but he ought to at least be informed. He ought to at least have as much information as can be brought to him before that decision is made.

We think that if the version of Senator Grassley's bill that has been presented to this committee is looked at, it would address all of those concerns that we have.

Let me just add in closing that if you have your staff take a look at the number of qui tam actions that have been litigated in this country, and you pick the time period, the last 5 years, the last 10 years, the last 15 years, they are going to have a difficult time finding any such cases, and the reason for that is because of the procedural hurdles that exist in the statute as it was amended in 1943 at the request of the Justice Department. It is not because there is not any fraud going on or there are no citizens that are concerned enough to step forward like Mr. Gravitt has.

That is not the reason, and I think that it is imperative that you gentlemen give full consideration to passing this bill out of committee and joining with the Senate in getting these amendments made, so that citizens and the taxpayers can have a role to play, can serve as another check and balance on the system that has been set up, to make sure that there isn't collusion between the executive branch of government and these defense contractors.

That is all I have to say at this time.

[The statement of Mr. Helmer follows:]

UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ADMINISTRATIVE LAW AND GOVERNMENTAL RELATIONS

TESTIMONY OF JAMES B. HELMER, JR.
FEBRUARY 6, 1986

My name is James B. Helmer, Jr., and I am an attorney licensed to practice law in the State of Ohio and in the District of Columbia. My law offices are located at 2305 Central Trust Tower, One West Fourth Street, Cincinnati, Ohio. I represent John Gravitt in his False Claims Act suit brought against Defendant General Electric Company.

I would like to echo the comments of Mr. Gravitt and the prior speakers in support of H.R. 3828 which would amend the False Claims Act and Title 18 of the United States Code regarding penalties for false claims and other purposes. My support is based upon both my personal experience in handling Mr. Gravitt's False Claims Act case and my experience in litigation in the federal courts.

I would like to add a few comments to those of Mr. Gravitt. First, I would like to emphasize to you the personal sacrifice which Mr. Gravitt and his family have made in involving themselves in this lawsuit in order to bring to light what they believe are illegal and immoral practices. Mr. Gravitt, after long and careful consultation with me and several other attorneys, as well as his family, made the difficult decision to bring this False Claims Act case and challenge one of the largest corporations in our country. What Mr. Gravitt did not tell you, by way of his background, is that he is a Vietnam war veteran, a former Sergeant in the United States Marine Corp., wounded in battle and a recipient of the Purple Heart. It was in learning about Mr. Gravitt's background, as well as the facts of his False Claims Act case, that I became convinced that his lawsuit was anything but frivolous. Indeed, the General Electric Company has admitted that "irregularities" in its claims procedure exist but claims that it only cheated itself of more taxpayers' monies as a result of these false billing claims.

I graduated from the University of Cincinnati Law School in 1975. Thereafter, I was a law clerk to Chief Judge Timothy S. Hogan of the United States District Court for the Southern District of Ohio. Since 1977, I have been in the private practice of law and my practice has been exclusively devoted to complex litigation, primarily in the federal Courts in Ohio. As such, I am very familiar with the impact that procedural changes can have upon substantive laws. Procedure can often prevent Congressional intent from being fulfilled. The False Claims Act, as it currently stands, is one example of how procedures can be used to thwart the Congressional intent of prohibiting false and fraudulent practices by defense contractors.

First, the current False Claims Act, as written, is a little-known law. It will remain unknown to most lawyers unless it is strengthened. Thus, whistleblowers, like Mr. Gravitt, will never be able properly to bring fraudulent practices of government contractors to the attention of the public because they will not be aware of the legal method of doing so. The amendments proposed will strengthen the Act and, therefore, make it more attractive to lawyers and litigants and, therefore, encourage persons with knowledge of fraudulent practices to bring them to the attention of the United States Government and will encourage both the Department of Justice and private litigants to prosecute fraudulent contractors.

As Mr. Gravitt testified, the proposed amendments which would increase the amount a private party such as Mr. Gravitt could recover as well as making the amount of recovery less discretionary with the Court, would help to make this statute much stronger and more attractive to litigants. As it stands now, even if his lawsuit is successful in recovering millions of dollars for the United States Government, Mr. Gravitt is not assured of one penny in compensation. It is completely within the Court's discretion as to the dollar amount to which he will be entitled and that amount will not be determined until the end of the litigation. This is a substantial risk that most potential False Claims Act plaintiffs could not undertake.

As the False Claims Act presently stands, there exists no protection from retaliation for whistleblowers like Mr. Gravitt. Ohio, like most states, recognizes the ancient doctrine of at-will employment which permits an employer to terminate an employee at any time for any or no reason. While there exists some statutory protection against discharge for certain discriminatory reasons, the Ohio Supreme Court has recently ruled that a whistleblower has no rights under Ohio law to be reinstated to his former employment. We advised Mr. Gravitt that there exists no federal or Ohio law by which he could regain his employment at the General Electric Company.

Thus, the amendments proposed which would provide protection from retaliation for those who oppose and bring to light false claims is critical. A job in our society is one of the main determinant factors of an individual's worth and ability to provide for his family. Unfortunately, few individuals have the courage displayed by Mr. Gravitt to risk their jobs to bring unlawful employer practices to light. Providing protection for employees will encourage them to step forward with their knowledge of improprieties.

The amendments to the Act which provide for attorneys fees, would also greatly strengthen the Act and make it more viable. Attorneys fees can vary greatly from case to case, depending upon the complexity of the case, the number of documents involved, the ferocity of the opposition, whether or not the Department of Justice is actively involved and does a thorough investigation, and upon numerous other variables such as the number of witnesses, the length of time involved, the number of procedural hurdles to overcome, etc. A provision allowing compensation for False Claims Act plaintiffs to request attorneys fees, in addition to their percentage recovery, would further encourage individuals to bring illegal practices to the United States Government's attention.

I further support the amendments which allow the False Claims Act plaintiff, by and through his counsel, to remain in the action as a full party even though the United States Department of Justice intervenes in the case. In Mr. Gravitt's action, for example, his participation has been limited to filing the initial action, serving discovery upon Defendant General Electric Company, and cooperating with FBI agents who were conducting the criminal investigation for the Department of Justice. In the civil action, the Department of Justice has not requested any discovery and its main activity has been to request that Chief Judge Rubin postpone the case until a later date and to request that the Court approve a "sweetheart deal" settlement. Fortunately, Chief Judge Carl B. Rubin operates an extremely efficient Court in the Southern District of Ohio, attempts to bring cases to trial within approximately one year of their filing, and will not permit a second fraud upon the Government to occur in his courtroom. Thus, he has denied the Department of Justice's latest requests for a postponement and has refused to approve the "sweetheart" settlement entered into by the Department of Justice and the General Electric Company. However, so long as Mr. Gravitt is not involved, the United States Department of Justice and the General Electric Company may well be able to "settle" this case for a nominal amount to avoid adverse publicity concerning defense procurement efforts. That issue, whether the Department of Justice can settle Mr. Gravitt's case, without his approval or that of Chief Judge Rubin is now before the United States Court of Appeals for the Sixth Circuit. Such a "sweetheart" settlement took place in a False Claims Act suit brought in 1982 against Litton Systems, Inc. involving Navy Contracts and may occur in this case, as well.

Plaintiff Gravitt's False Claims Act Case

Qui Tam Plaintiff John Michael Gravitt filed his action against Defendant General Electric Company (G.E.) on September 26, 1984, alleging extensive, willful falsification of G.E. employee time cards used to calculate charges to the United States Government pursuant to defense contracts. The United States Government, through the Department of Justice and the United States Attorney for the Southern District of Ohio, intervened in the action in December 1984 to proceed with the action and represent the Government's interest. Upon intervening, the Department of Justice simultaneously moved for a stay of the civil proceeding pending a criminal investigation of Mr. Gravitt's allegations. Thereafter, the United States Department of Justice filed two additional motions seeking additional delay in the civil proceeding. The first such motion was granted; the second motion was denied. As the trial date approached, the Department of Justice still had conducted no formal discovery in this civil action.

When his action was filed, Mr. Gravitt served his First Set of Interrogatories and First Request for Production of Documents on Defendant G.E. simultaneously with the Complaint. Approximately forty days later, Mr. Gravitt noticed the depositions of Brian Rowe, Senior GE Vice President and Group Executive, and R. G. Gavigan, G.E.'s Internal Auditor, who previously informed Qui Tam Plaintiff Gravitt that substantially all of Mr. Gravitt's allegations had been proven as true and that the remainder could not be disproven. However, when the Department of Justice intervened in this action and secured a stay of this action, all discovery initiated by Qui Tam Plaintiff Gravitt ceased. Thereafter, the United States Department of

Justice conducted its criminal investigation led by Special FBI Agent John Ryan, who was, by his own admission, distracted by his simultaneous responsibility for the investigation of the Home State Savings Bank failure case. Consequently, the Department of Justice's investigation of this case consists solely of the criminal investigation.

The Department of Justice has no actual accounting of the time spent on the criminal investigation, yet it estimates that 5,000 man hours were expended. There has been no formal civil discovery, no collection of any testimony under oath, and no accounting of the hours expended by the Department of Justice in this civil proceeding. Furthermore, the United States attorneys and Department of Justice attorneys handling this civil proceeding have never moved for disclosure of the results of the Grand Jury's investigation, as required by Rule 6(e) Fed.R. Crim. P. See also United States v. Sells Engineering, Inc., 463 U.S. 418 (1983) (held grand jury materials generated through tax fraud prosecution not available to Department of Justice Civil Division attorneys absent a showing of particularized need pursuant to Rule 6(e)(3)(c)(i), Fed. R. Crim. P.). Therefore, the attorneys for the Department of Justice who negotiated the proposed settlement do not possess the information generated by the Grand Jury's investigation nor any information from formal discovery. It is on this basis that the proposed settlement rests.

Following Chief Judge Rubin's denial of the Department of Justice's Second Motion for Enlargement of Time, Qui Tam Plaintiff's counsel appeared for the Final Pretrial Conference scheduled for November 15, 1985. Neither G.E.'s counsel nor counsel for the Department of Justice appeared. Chief Judge Rubin conveyed to Qui Tam Plaintiff's counsel the message he had received that the case was settled. This was the first time Qui Tam Plaintiff's counsel heard of any proposed settlement. Subsequently, Chief Judge Rubin rescheduled the Final Pretrial Conference as a Status Conference which took place on November 26, 1985 in the Judge's chambers.

At the November 26, 1985 Status Conference, Chief Judge Rubin established the following procedure for disposition of this case. First, Chief Judge Rubin scheduled a hearing on the issue of whether the District Court had jurisdiction to supervise and approve the proposed settlement, with oral argument to be based upon an assumption, in no way a proven fact, that the Government had knowledge of the information on which Mr. Gravitt's suit was based prior to the time Mr. Gravitt filed suit. Second, the Court determined that if it lacked jurisdiction over the matter if the Government had such prior knowledge, the Court would hold a second hearing to actually determine the factual issue of whether the Government possessed all knowledge on which Qui Tam Plaintiff Gravitt's suit was based prior to his bringing this action. Finally, if the Court found that its jurisdiction survived these two hearings, the Court would proceed to determine the adequacy of the proposed settlement. In accordance with this procedure, Chief Judge Rubin scheduled a hearing on the jurisidictional issue for December 13, 1985.

Immediately prior to the December 13, 1985 hearing, G.E. and the Department of Justice filed an executed Stipulation of Dismissal of this action. Chief Judge Rubin refused to accept the Stipulation of Dismissal and proceeded to hear arguments on the jurisdictional issue. In addition, all parties filed briefs with the Court in anticipation of the jurisdictional hearing.

During the hearing on the jurisdictional issue, the parties' positions emerged as follows: Qui Tam Plaintiff Gravitt contended that the District Court has jurisdiction over this action and must approve any settlement of the action even if the Government had the information on which his action was based at the time he filed suit. Defendant G.E. acknowledged that the District Court has jurisdiction because the Government proceeded with the action and has jurisdiction to approve the settlement, but contends that Qui Tam Plaintiff Gravitt cannot be heard on the issue of the adequacy of the settlement. Finally, the Department of Justice contended that the District Court has no jurisdiction to approve the proposed settlement of this action, but only has jurisdiction to hear the case if the Department of Justice chooses to proceed. No factual evidence was presented by any party during the hearing.

On January 8, 1986 the District Court issued an Order vacating the Stipulation of Dismissal and certifying the jurisdictional issue as one appropriate for an interlocutory appeal pursuant to 28 U.S.C. §1292(b). Chief Judge Rubin expressly stated that his vacating of the Stipulation of Dismissal was "not an appealable Order pursuant to 28 U.S.C. §1292(b)."

Subsequently, Qui Tam Plaintiff Gravitt and both GE and the Department of Justice filed Petitions for Permission to Appeal on January 21, 1986 with the United States Court of Appeals for the Sixth Circuit. All parties have filed briefs with that Court.

The issue certified by the District Court as appropriate for interlocutory appeal pursuant to 28 U.S.C. §1292 is whether the District Court has jurisdiction to pass on the adequacy of the proposed settlement in a Qui Tam False Claims Act proceeding in which the Government has proceeded, even if the information on which the suit is based was known to the Government prior to the filing of the action. This is the only issue which is properly subject to any parties' Petition for Leave to Appeal.

There has been no concession by Qui Tam Plaintiff Gravitt or his counsel and no factual determination made that the information on which this action is based was known to the Government prior to the filing of this action. Further, Chief Judge Rubin's Order of January 8, 1986 does not constitute a factual determination that the Government had the information on which Gravitt's suit was based prior to the time it was filed.

Nonetheless, G.E. and the Department of Justice erroneously have suggested that the United States Court of Appeals for the Sixth Circuit can dispose of this case on interlocutory appeal. The Court of Appeals has refused to do so.

Qui Tam Plaintiff Gravitt was and is prepared to prosecute this action on behalf of the United States Government. Because the Department of Justice has intervened, Qui Tam Plaintiff Gravitt has been relegated to the sidelines. From the sidelines, he has watched the Department of Justice repeatedly move to delay this action, and then attempt to settle the action without conducting any formal discovery, without securing any formal testimony under oath and without even obtaining the fruits of the Grand Jury investigation. Furthermore, Qui Tam Plaintiff Gravitt has seen G.E. plead guilty to criminal charges and submit to the maximum penalties based on virtually identical allegations of misvouchering in the case of United States v. General Electric, C-1-85-112 (E.D. Pa. 1985). From his perspective, Qui Tam Plaintiff Gravitt is convinced that the proposed settlement of this action is a "sweetheart deal" negotiated between Defendant G.E. and the Department of Justice.

During the pendency of this action, Qui Tam Plaintiff has been offered a portion of the proposed settlement, and has been threatened should he decline it. Based upon both moral and civic obligations to bring to the Court's attention his knowledge of the inadequacy of the proposed settlement, Qui Tam Plaintiff Gravitt declined the money and withstood the threats.

In short, Qui Tam Plaintiff Gravitt is entitled to be heard, as a proper relator, on the adequacy of the proposed settlement. Furthermore, as the motivating force in this litigation, Qui Tam Plaintiff Gravitt is uniquely qualified to assist the Court in making an informed determination as to the adequacy of any proposed settlement. Finally, Qui Tam Plaintiff Gravitt has undergone considerable personal sacrifice in bringing this action. Public policy considerations demand that the qui tam provisions of the False Claims Act be given their intended purpose of providing qui tam plaintiffs the opportunity to participate meaningfully in the disposition of such actions. Defendant G.E.'s protestations that any participation by Qui Tam Plaintiff Gravitt in the factual determination of the adequacy of the proposed settlement will inconvenience the parties by rendering such a determination closely akin to an adversarial proceeding or trial should not be accepted. Mere inconvenience does not outweigh the public interest of maintaining the vitality of the qui tam provisions of the False Claims Act and having an informed District Court perform its statutory and constitutional duty of reviewing the adequacy of any proposed settlement in this defense contractor fraud action.

Qui Tam Plaintiff Gravitt can demonstrate the inadequacy of the proposed settlement. As noted in the Department of Justice's Memorandum Regarding Jurisdiction and Standing of the Relator, filed with the District Court and attached to the Department of Justice's Petition for Leave to Appeal, the Department of Justice took a representative sample of 10,000 time vouchers as the basis for its investigation. Through conversations with counsel for the Department of Justice and several individuals involved with the investigation, Qui Tam Plaintiff has learned that 3,000 - 4,000 of these 10,000 vouchers had been falsified. Furthermore, according to the Department of Justice's application of the criminal counterpart to the False Claims Act, 29 U.S.C. § 1001, in United States v. General Electric, CR-1-85-112 (E.D. Pa. 1985) each falsified time voucher represents a false claim for which a $2,000.00 forfeiture is recoverable. The False Claims Act imposes the same $2,000.00 penalty for each false claim. See 31 U.S.C.

§3729. Assuming the six month sample selected by the Department of Justice is representative of the three year period Qui Tam Plaintiff was employed by Defendant GE, the number of false claims ranges from 18,000 to 24,000. As each false claim carries a forfeiture of $2,000.00 which is recoverable without demonstration of any damages to the government, the potential recovery by the United States is between $36,000,000.00 and $48,000,000.00. Certainly, the proposed settlement of $234,000.00 is woefully inadequate. Discounting the amount recoverable because of the hazards of litigation, Qui Tam Plaintiff believes that an appropriate settlement figure is in the neighborhood of $24,000,000.00.

HR 3753

In regards to HR 3753, I would whole-heartedly support a change in Title 31 to increase the liability of any person who violates §3729 of that title by making the amount of penalty assessed three times, rather than two times, the amount of damages the United States Government sustains as a result of each such violation.

HR 3828

Likewise, as to HR 3828, I would support the provisions therein making the amount of the penalty per false claim submitted to be $10,000.00 rather than $2,000.00; making the damage penalty a treble damage provision, rather than merely a double damages provision; and providing for consequential damages. In addition, I support the amendments to §3730(b) set forth in HR 3828 which continue to give the Government sixty (60) days in which to determine whether or not to enter a False Claims action, but provides that the person bringing the action, such as my client, whistleblower John Gravitt, shall have a right to continue in the action as a full party on his own behalf. Likewise, I support the change clarifying the situations in which the Court may dismiss actions. The proposed amendments limit such dismissals to actions based on the specific evidence or information that the Government previously disclosed in administrative, civil or criminal proceedings or to actions based on specific information disclosed during congressional investigations or disseminated by news media. Further, the Act, as amended, specifically permits Qui Tam plaintiffs, such as Mr. Gravitt, to file civil actions where the Government, although aware of false claims, does not, within six (6) months of becoming aware, initiate a False Claims Act proceeding.

I also support the provisions which provide that the percentage of the proceeds of the action or settlement of the claim to be awarded to the Qui Tam plaintiff may range from at least 15% to as much as 30%, according to the contribution of the Qui Tam plaintiff. As the statute is now worded, a District Court could absolutely deny the Qui Tam plaintiff any proceeds of the judgment or settlement, regardless of the amount of contribution of the Qui Tam plaintiff.

I would also like to add some comments regarding §3730's proposed amendments providing relief for discrimination for employees who report violations. Approximately half of my law firm's practice involves federal litigation of employee discrimination claims. Primarily, I represent employees who have been discriminated against, but I have also represented employers. I completely support the provisions providing for protection for such "whistleblowers." As Mr. Gravitt has told you, he lost his job with the General Electric Company as a result of his refusal to falsify time vouchers. There is currently no legal remedy which can assure him re-employment with his former employer. Moreover, I support the mandatory requirement that whistleblowers be reinstated with full seniority rights, receive back pay with interest, and receive compensation for any special damages suffered, including attorneys fees.

The only way to signal to a discriminating employer and to an intimidated work force that submission of false claims shall not be condoned, is to return the employee who brings changes against his employer back to work. Without such a remedy, other employees will conclude that it is not in their own self-interest to report false claims, and, worse, conclude that the United States Government does not support them in bringing false claims to the Government's attention. Further, it is necessary to provide for attorneys fees in such cases, because otherwise the attorneys fees entailed would be virtually impossible for any private litigant to pay. I would imagine that many of you sitting here today could not afford to pay the $50,000.00 to $150,000.00 in legal fees and costs necessary to win such a lawsuit.

Likewise, the provision of double damages for backpay and punitive damages makes it more likely that discriminating employers will not be able to discriminate against conscientious, "whistleblowing" employees with impunity. Without the provisions enabling employee discrimination victims to recover substantial damages, it would be in an employer's best interest to go ahead and discriminate and risk the possibility of a lawsuit, since the amount of damages recoverable could otherwise be quite small. In short, for the anti-retaliation provisions of the False Claims Act to amount to more than a mere "paper tiger," an employer must fear substantial damages in the form of double damages, interest on back pay amounts, attorneys fees, special damages, and punitive damages, as well as reinstatement of the employee.

HR 3317

I would like to make the following comments regarding HR 3334 entitled "The False Claims Act Amendments of 1985." I generally support all of the proposed amendments to 31 U.S.C. §3729 set forth as I believe they make the present act a stronger anti-fraud statute.

As regards HR 3334's amendments to 31 U.S.C. §3730, I would like to make the following comments. While I support the provisions which clarify the jurisdiction for such actions, generally, I do not believe that the remaining provisions in HR 3334 will greatly assist the Government in prosecuting criminally or civilly persons who submit false claims for payment to the Government. The False Claims Act and the Federal Rules of Civil

BEST CO BLE

Procedure and Criminal Procedure, not to mention the specific statutes and regulations governing particular governmental programs, already provide the Attorney General and the Government with the ability to collect the necessary materials and information to determine whether false vouchers have been submitted. There is no need to set up an alternative or duplicative system.

Further, HR 3334 does not address the inadequacies of the False Claims Act that have come to light as a result of the litigation of John Gravitt's False Claims Act case against defense contractor General Electric Company. That is, HR 3334 does not clarify the appropriate role for a Qui Tam plaintiff such as whistleblower John Gravitt. Likewise, it does not assist the Federal District Court in determining its jurisdiction to handle cases where there is an allegation that the information was previously known to the Government or where there is a proposed settlement, such as the "sweetheart" settlement which the United States Department of Justice has tried to force upon the Federal District Court of the United States District Court for the Southern District of Ohio. Nor does HR 3334 provide any "whistleblower" anti-retaliation provisions for employees. In short, HR 3334 does not address the glaring inadequaciess of the False Claims Act that the United States District Court for the Southern District of Ohio has encountered.

HR 2264

I would like to make the following comments regarding HR 2264, the proposed "Program Fraud Civil Penalties Act of 1985." While the purpose of this proposed amendment is laudable, I believe that there are a number of problems in the proposed legislation. First of all, I believe that it is inappropriate and inconsistent with the "separation of powers" principles upon which our form of government is based to have the judicial power to determine whether false claims have been submitted to be entrusted to persons under the control of the Executive branch of Government. Further, this legislation does not require or insure that the "authority head" charged with conducting "impartial hearings" have any training or experience in the law or in conducting administrative procedures. Further, the standard of review by the United States Court of Appeals, that the decision below must be "supported by substantial evidence on the record considered as a whole" is a standard inconsistent with appellate review and can only benefit the perpetrator of the fraud by delaying the outcome or overturning the findings that fraud has occurred. Moreover, I question the ability of any department to determine, in most cases, prior to initiating the proceeding under this Act, if the amount of the false claim or the amount of the damages is less than $100,000.00. Further, our Government should be spending most of its time investigating fraud in excess of $100,000.00, not wasting time on $500.00 cases.

HR 3335

I would also like to make the following comments regarding HR 3335, entitled "Program Fraud Civil Penalties Act of 1985." This bill wisely provides for an independent hearing examiner or administrative law judge to make determinations regarding the submission of false claims. This proposed bill, however, permits the Attorney General to either stay or absolutely stop investigations of alleged false claims. I see no purpose in such a provision, except for the Executive Branch to hide what it believes is politically embarrassing fraud and, worse, to allow "friends" of the then current Administration to escape punishment.

Closing Remarks

In short, I heartily support HR 3828's amendments to the False Claims Act. The amendments strengthen and clarify the Act and make it a more viable anti-fraud statute. If the Committee would like any additional information from me or my client, John Gravitt, regarding his False Claims Act case, we stand ready to assist you. Thank you for the invitation to address you today.

Mr. **Glickman**. I want to thank you also for an excellent statement.

Mr. Gravitt, I would like to ask you, before we get into the qui tam issues, to get a little for the record of the committee, a little better understanding of the chronology when you first found out or discovered timewise that the vouchers were being improperly modified and the time length between that and your discussions when you filed suit, because I want to try to get a feeling for the facts.

Mr. **Gravitt**. There was a progression over somewhere in the neighborhood of about 3 years of putting it all together. The first instance that I knew something was wrong was about my second week at General Electric, and they wanted to know what I thought about GE, and I asked them how they were staying in business with the amount of work that was being done.

They smiled and said, "We will explain to you how to do it."

About 3 months later we were having difficulty with the training program, a very elaborate training program. We were on afternoon shift. We got the junior people out of 50 machinists, we had somewhere in the neighborhood of 30, in the trianing mode, but if we charged the time to training, nonproductive time, it came out of a budget which they said we were running overbudget on training. We tried to nail it down. How much budget do we have. The end result was we don't have any budget, so while you are training people, you charge them all to the job.

Now, this creates two problems. You put two people on the same job while you are in training. One man is teaching, one man is learning. If you get 50 percent productivity you are doing well. Instead of one man doing 4 hours working at $50 an hour, you have one man training another man, and you are working 8 hours at $100 an hour, you are putting $1,600 into the job, and you are only getting $200 worth of work accomplished. But we were told there is no budget for the training. Don't charge it to nonproductive time. Charge it off to the job.

This progressed into other areas. Then one afternoon the foreman and myself were called into my supervisor's office, and we were told that there are certain jobs and cost overrun situations, and you will not charge time to that. You will change the numbers.

He and I both refused to do it. The question of budget is one thing, but falsifying company records is another thing. That is when we first discovered the real problem.

Mr. **Glickman**. The fellow who asked you to falsify the records, did he ever tell you that this was coming down from on high? Did you ever get the clear feeling that his supervisor——

Mr. **Gravitt**. At that point in time, no. We thought, gosh darn, we have just got a boss that is not doing things correctly. After that, we had a meeting with a member of management and other members three or four levels high to discuss the budget on training, and we were—then on down the road I was in a training session in school, and the subject of vouchers came up, and in this group we had foremen from all over General Electric, and managers from all over General Electric, and vouchers came up, and I stood and told them the vouchers that were going into the office were not the same vouchers that were coming out of the office.

One of the foremen tried to pull me down in my chair. He said, "Shut up, you are going to get fired." In the meantime, other foremen started talking about their problems with vouchers, and it almost turned into a riot, because the foremen were upset. They thought like we thought, we are the only ones who have this problem, but it appeared that it was throughout General Electric. The class was cut off. That was it. That was it for the remainder of the day.

It was at this point in time when things were bad, and that particular night I was put into the hospital for emergency surgery. I was off work for about 6 months. During that period of time, my fringe benefits were canceled. The salary continuance program was canceled on me. A month before I returned to work I was notified that I was going to be laid off, that if I could find a job out there somewhere find a job. Don't bother to come back to GE because you are in trouble.

Well, I reported back to GE, and 2 weeks later I was put back in the same foreman's position.

Mr. GLICKMAN. Let me ask this question to your attorney:

The status of any criminal investigation in this case, you stated that but I lost it somewhere. What happened?

Mr. HELMER. The U.S. attorney's office elected not to indict anyone and stop the criminal investigation. This would have been around the end of September 1985. Now, interestingly, at the same time that that decision was made, Brian Rowe issued a memorandum to all General Electric employees, which I brought a copy with me, in which he admits that intentional—not mistakes—intentional misvouchering, false vouchering, was going on at General Electric, and this was uncovered in the investigation.

We learned that the Justice Department's criminal lawyers were not aware of that, nor were the Justice Department lawyers on the civil side when they made their decision not to go forward. This is I think what most lawyers refer to as an admission against interest. It was published and distributed to all General Electric employees. The Government did not have it.

Mr. KINDNESS. Mr. Chairman, might a copy of that be submitted as a part of the record?

Mr. GLICKMAN. Of course. Why don't you bring a copy up here so we can look at it and then put it in the record.

[The memorandum follows:]

From the front office, General Electric Aircraft Engine Business Group, September 1985

DON'T YOU BELIEVE IT!

(By Brian H. Rowe)

B.H. ROWE REFLECTS ON SOME MYTHS AND MISCONCEPTIONS AND DOWNRIGHT ERRORS

"It's all military business. It doesn't make any difference how we voucher."

Some few naive people thought that it was OK to voucher hours from a military contract being overrun to one that was underrun because in the end the Government paid all the bills. This is not so! It is illegal and a bad way to run any business, military or commercial. We are not only required by Contract and Law to voucher accurately but we need to know our actual cost performance to help correct waste and estimate further contracts.

"It's OK to get rid of 'missing time' by charging to process pools or other 'creative accounting' techniques."

We are concerned about "missing time" and want it fixed! However, we want it fixed by correcting system problems, processing transfers promptly, updating planning, attention to detail at all levels and all the other actions needed to fix the problem. To fix it with the "Stroke of the Pen" is misvouchering and would invite disaster for the individual doing so and the AEBG as well.

"It's OK to dump excess costs or job overruns into overhead."

This is a clear violation of our Instruction and Federal Law. We don't like cost overruns but want them kept minimal by careful planning in quoting and close control of costs as they are being incurred. Let's profit by our mistakes and learn how to do the job better the next time. When you attempt to cover up an overrun you risk severe discipline and hurt AEBG's Cost Superiority program.

"The efficiency measurements are what's important. Meet product cost bogeys even if you have to fiddle the books."

We must ship quality products at competitive costs. But we have to do it with absolute honesty and integrity! The military expects us to be absolutely scrupulous in the accounting of costs. Our Corporate Office expects this! I expect this! You must call the shots with integrity. Follow the rules! We will be better off in the end.

"Ownership means letting go once you set the goals and schedules."

Don't you believe it! Delegation is fine but abdication is not. Managers and supervisors have to satisfy themselves that corners are not being cut; how the job is done is as important nowadays as the end result and managers have to satisfy themselves that work is being done properly - according to the rules - with top quality!

"It's OK to help a friend meet his efficiency by letting him voucher your work."

This is also a violation of our work rules and Government Contract Requirements. Good team work is highly desirable, but help your buddy with coaching and explaining better ways to get the job done. Both of you will be in trouble with misvouchering.

"Let's take people who belong in overhead and make them applied so we can meet our head count."

Head count and overhead rates are very real problems. Don't solve them by misclassifying people and instructing them to voucher illegally. Everyone should look at themselves and their organization and be comfortable that no one is being forced to do "creative" vouchering. If you feel your supervisor or manager is putting you in such a position, make sure you express your concerns to him, and if no action is taken to correct the situation you should contact your Ombudsperson or Legal.

"We're not going to have idle time in this place!"

This statement is simply not realistic. It is the kind of thing that causes people to do dumb things. We want complete honesty, complete integrity in all of our record keeping. Concealing and hiding problems helps none of us, and the act of hiding and concealing puts the individual and the Company in legal jeopardy.

A FINAL NOTE

As you know, we have been conducting a large number of labor voucher audits. While we have found a number of procedural errors and practices, and we have set about to correct these deficiencies, we have also found a few instances of conscious mischarging. I cannot overemphasize the seriousness of this practice. That kind of stupidity could bring the business to its knees! - and I mean it!

Also we still find inexcusable administrative laxity. Some people haven't yet gotten the message. Some still put the Company and themselves in jeopardy by cutting corners, by not thinking, by innocent errors-and some think "looking good" is more important than their personal honesty, integrity, or jobs.

Ignorance is no excuse! In a court of law not knowing any better is a hollow defense. The worst part is, our collective reputation, which we cherish, suffers when one of us makes a mistake. I ask that you do your part to enhance and uphold our reputation and if you see others compromise us I ask that you call it to our attention. I thank you for reading this! I will thank you more for paying heed, for speaking up, for protecting our Company and for our jobs and for defending our integrity with all your energy.

Please remember, we are not out to get anyone. We are trying to correct a bad situation, and we need all of your help.

Mr. GLICKMAN. Mr. Brown.

Mr. BROWN. Mr. Chairman, as I have listened to the testimony, it seems to me that the Justice Department may well be guilty of possible misconduct themselves. There is certainly an indication here of some possible misconduct in the Justice Department itself. I would ask that this committee take a copy of this testimony, forward it to the Attorney General, ask him to investigate. I would also hope that this committee would be willing to have the Attorney General come and answer.

Mr. **Glickman**. I think your request to alert the Attorney General as to the contents of this testimony is a good suggestion. I would suggest that what we do is once the hearing is finished that majority and minority staff draft a letter to the Attorney General doing that.

Let me go back to the basic subject of the hearing. It is clear, Mr. Gravitt, that your involvement started the entire proceedings, that is your initial investigation, but that didn't seem to do very much. Your qui tam proceedings brought the Justice Department in. They were not in on this case at all beforehand; is that correct?

Mr. **Gravitt**. That is correct.

Mr. **Helmer**. Could I clarify that?

Mr. **Glickman**. Yes.

Mr. **Helmer**. Mr. Gravitt sent an eight-page single-spaced typed letter to Mr. Rowe prior to his discharge. As a result of that letter, there was some investigation done at General Electric, and there was another letter sent from a man named Krall at General Electric to a Colonel Lynch of the U.S. Air Force. It is a four-paragraph-long letter, in which General Electric states that their investigation, which was prompted by a foreman from DMO, which was Mr. Gravitt, has uncovered I believe at that time they said misapplication of the vouchering procedures. That letter, which as I say is only four paragraphs long, is what the Justice Department is now pointing to and saying, "Well, we knew about this all along, therefore Mr. Gravitt cannot properly bring a lawsuit."

Mr. Gravitt when he filed his complaint in October 1984, supplied the Justice Department with a 20-page affidavit setting forth names, dates, phone numbers and places of his evidence. That 20-page affidavit is I believe in stark contrast to the 4-paragraph letter that the Justice Department is refering to from Mr. Crawl to Colonel Lynch.

Mr. **Glickman**. This four-page letter, again, when was it written?

Mr. **Helmer**. Four-paragraph letter.

Mr. **Glickman**. Four-paragraph letter. When was it written?

Mr. **Helmer**. It was written sometime in 1983.

Mr. **Gravitt**. I believe it was——

Mr. **Helmer**. Mr. Gravitt's suit was broght 1 year later.

Mr. **Glickman**. Have you seen that letter?

Mr. **Helmer**. Yes, I have. I have a copy of it. I don't believe I brought it with me, though.

Mr. **Glickman**. Could you get a copy of that letter for our record also?

Mr. **Helmer**. Yes, sir.

[The information follows:]

GENERAL ELECTRIC

NOV 2 3 1983

W. G. KRALL
VICE PRESIDENT AND GENERAL MANAGER
EVENDALE PRODUCTION DIVISION

AIRCRAFT ENGINE BUSINESS GROUP
CINCINNATI, OHIO 45215

November 21, 1983

Paul D. Lynch
Colonel, USAF
Air Force Plant Representative
General Electric Company
Cincinnati, Ohio 45215

Dear Paul:

The purpose of this letter is to summarize the results of our audit of the alleged labor vouchering irregularities in the Development Manufacturing Operation (DMO). This review was performed by Evendale Production Division financial personnel under the direction of Evendale Internal Auditing. In addition, support in the statistical application was provided by General Electric's Corporate Audit Staff.

As you recall, allegations concerning improper labor vouchering in DMO were first made this past summer by a former employee. The existence of improper practices was confirmed during extensive interviews conducted by personnel from Evendale Auditing and Security. During these discussions, the interviewers indicated that the motive for the improper practices was to meet internal measurements.

During October 1983, a voucher sample was selected for review. The purpose of this review was to quantify the potential dollar impact of the irregular practices on Government contracts. The sample was a dollar unit sample, and consisted of 133 vouchers. The total population was vouchers from the three year time period which aggregated $6.1M in extended cost. Statistical extrapolation of the errors disclosed in the sample has resulted in a 95% confidence level in the following projected impact for the three year time period:

Underbilling to Government	$185 000
Overbilling to Government	138 000
Net underbilling to Government	$ 47 000
No effect	$163 000
Unknown	$ 41 000

Although the results of the sample did not indicate any net adverse impact on Government contracts, and although this situation occurred in a relatively small operation (DMO), we consider that the identified problems represent a serious breach of our policies. Accordingly, the following actions have been taken to ensure meeting our commitment to proper vouchering practices:

1. On December 15, each Department Manager in Manufacturing will issue a letter to all salaried employees affirming our commitment to proper adherence to voucher instructions.
2. Attached to the letter will be a revised, more comprehensive vouchering instruction.
3. Each supervisor will be required to sign an acknowledgment form that he understands the vouchering procedures and will adhere to them.
4. The three managers who were involved in the improprieties have received appropriate disciplinary action.

I would be happy to discuss this further at your convenience.

Sincerely,

George

W.G. Krall

/djw

Mr. **Gravitt**. It might be interesting, the letter to Colonel Lynch. Colonel Lynch was relieved and quietly replaced with another officer, put in charge of aircraft unit at General Electric, and as we understand it, Colonel Lynch is no longer with the Air Force anymore. He is in private industry somewhere, but we don't know with whom.

Mr. **Glickman**. Referring to him, were there military procurement officers in and around the GE plant where you were working at the time?

Mr. **Gravitt**. I saw several Air Force officers almost daily. As far as them coming into the departments or looking at anything or what their actual positions were, I couldn't tell you.

Mr. **Glickman**. Do you know if the Defense Contract Audit Agency was auditing these vouchers or any of the contracts at the time?

Mr. **Gravitt**. I asked Mr. Morehouse that same question. He said that they periodically went out and audited different units, and I asked him how the Department, with 75 people in it and 3 out of 8,000 vouchers in 6 months were visibly falsified, how come that the Defense Contract Agency auditors office didn't catch it when a 3-year-old could have sorted them out for you, he could not answer that question, nor could the Justice Department answer approximately 100 questions that we asked them when we saw them a few months ago.

Mr. **Glickman**. You say you have copies of the vouchers. I would like to have those as well for the record, if we could.

[The vouchers follow:]

[illegible]479 RESOD 2929 0109 1 6-15-83

1	KR138	8		21	60	9999-7
2						
3						
4						
5						
6						
7						
8						

LABOR VOUCHER

8

N Dragunoff

42991 MARTUNOVIL 2929 0109 1 6-15-83

1	KR138	8	0	21	110	9999-2
2						
3						
4						
5						
6						
7						
8						

LABOR VOUCHER

8 0 TOTAL

N Dragunoff

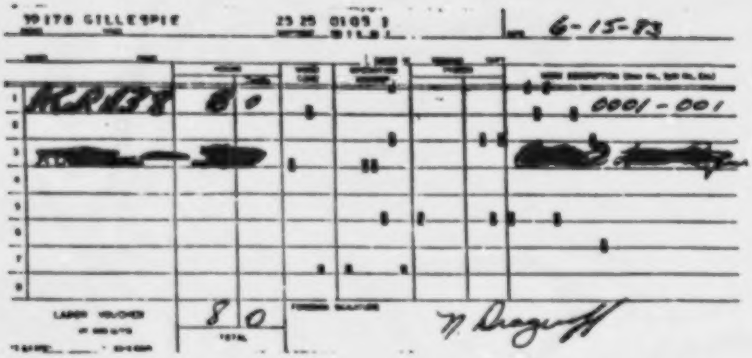
[illegible] 6-15-83

1	KR138	4			150	9999-4
2	D5934	4			150	9999-3
3						
4						
5						
6						
7						
8						

LABOR VOUCHER

8 0 TOTAL

N Dragunoff



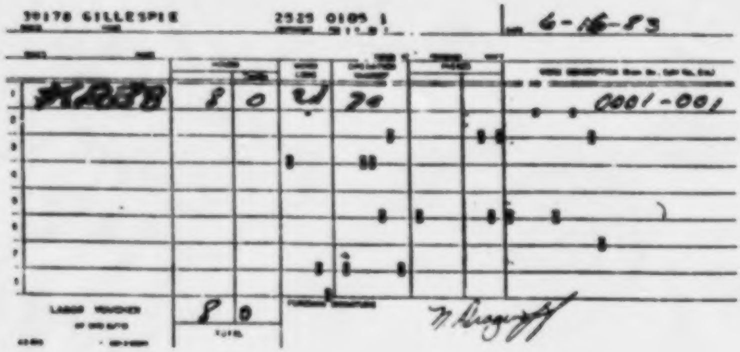
39170 GILLESPIE 2525 0105 1

6-15-83

1	KR138	8 0	0001-001
3	[redacted]	[redacted]	[redacted]

LABOR VOUCHER

TOTAL 8 0



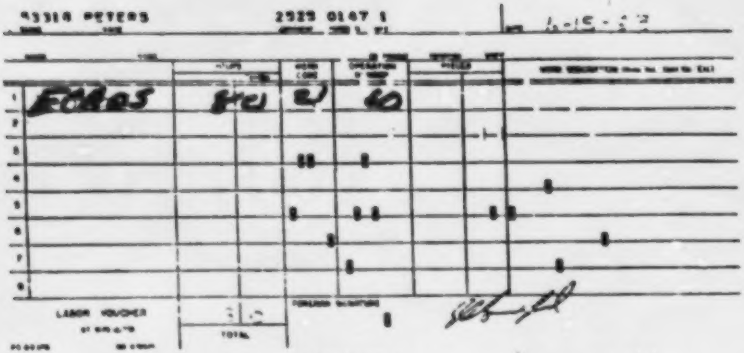
39170 GILLESPIE 2525 0105 1

6-16-83

1	KR138	8 0	21	70	0001-001

LABOR VOUCHER

TOTAL 8 0

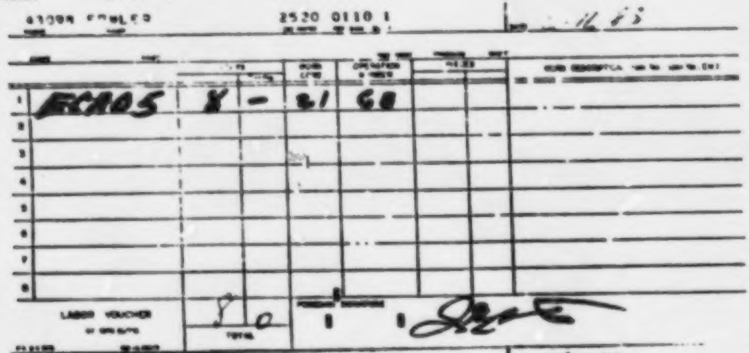


93318 PETERS 2525 0147 1 6-15-83

1	ECROS	8	0	21	60
2					
3					
4					
5					
6					
7					
8					

LABOR VOUCHER

TOTAL 8 0

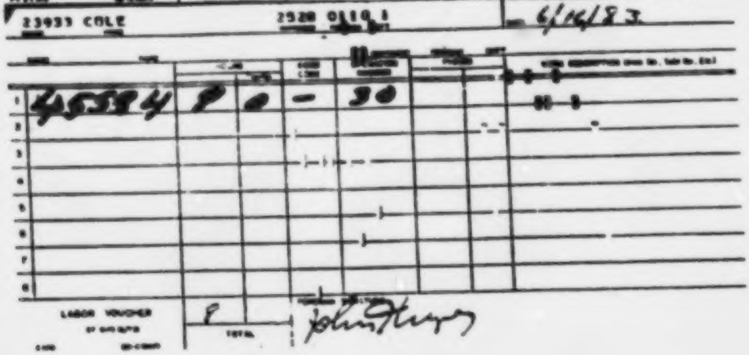


43098 FOWLER 2520 0110 1 6-16-83

1	ECROS	8	-	21	60
2					
3					
4					
5					
6					
7					
8					

LABOR VOUCHER

TOTAL 8 0



23933 COLE 2520 0110 1 6/16/83

1	45584	8	0	-	30
2					
3					
4					
5					
6					
7					
8					

LABOR VOUCHER

TOTAL 8

2925 0213 2

KUNK[illegible]

6-16-83

1	[illegible]062	80		[illegible]			9902 [illegible] 009
2							
3							
4							
5							
6							
7							
8							

LABOR VOUCHER

TOTAL 8 0

R. [illegible]

6-16-83

1	[illegible]062	80	21	350			9999-003
2							
3							
4							
5							
6							
7							
8							

LABOR VOUCHER

TOTAL 8 0

R. Jackson

2929 0105 1

6/13/83

1	[illegible]062	80	[illegible]	350			[illegible]-003
2							
3							
4							
5							
6							
7							
8							

LABOR VOUCHER

TOTAL 8 0

11 [illegible]

BEST COPY AVAILABLE

Mr. HELMER. I would just like to point out these are just by way of illustration. We have many, many others, and apparently the Government looked at additional thousands, although they do not have the originals. The originals have been kept by General Electric.

Mr. GLICKMAN. Are these extra copies for us?

Mr. HELMER. Yes, sir.

Mr. GLICKMAN. One final question before I go on, because we could talk forever. Going back to the qui tam provisions, Mr. Gravitt, you stated that you thought that citizen plaintiffs should be fairly but not overly compensated. Do you think it would be necessary for the private citizen to know that he will make money by filing such an action in order to go through with the action, or should the reimbursement be for money and time spent as well as attorneys fees and nothing more?

Mr. GRAVITT. I think the primary issue there, sir, is that a citizen who brings the action will be protected. We have received many, many, many phone calls concerning this, and one important facet of this is all of the phone calls and the letters have been supportive. Not one call has been negative, but even the people that have additional information at this time want to remain anonymous. They won't give us their names. They will call in and tell us things but they won't give us their names, because there is no protection for them.

Mr. GLICKMAN. Thank you. Mr. Kindness.

Mr. KINDNESS. Thank you, Mr. Chairman.

Mr. Gravitt, Mr. Helmer, I certainly want to thank you for your testimony and for particularly being here at your own expense, Mr. Gravitt. I can't help being quite a bit concerned about the role of the Department of Justice as described in the testimony this morning in the handling of this case. If I understand correctly what was presented by way of testimony, Mr. Gravitt's qui tam action was not handled by the U.S. attorney's office of the Southern District of Ohio, but by the Justice Department out of Washington, through personnel assigned from Washington probably, or do you have any knowledge about that?

Mr. HELMER. Yes, sir, you are correct. There were two assistant U.S. attorneys from the Southern District of Ohio's U.S. attorney's office involved, but they were simply there as local counsel. The qui tam part was handled by an assistant attorney general from the Justice Department here in Washington. This gentleman informed me that it was his responsibility to handle all qui tam actions brought in the United States, and that in fact he had done so for the last 4 or 5 years.

Mr. KINDNESS. Could we get his name?

Mr. HELMER. His name is Vincent Terlep. Mr. Terlep was asked by me as to how many of those qui tam actions he had tried in the last five years, and I was told none.

Mr. KINDNESS. There are a lot of questions to be asked, but I hardly know where to start. I think, Mr. Chairman, I would suggest that the record remain open for inquiries, questions to be presented by way of follow-up on this testimony this morning, and the responses to it.

Mr. Helmer, I would appreciate it if you might help us with the responses to such further questions as the subcommittee feels we need to ursue.

Mr. Chairman, like Mr. Brown, I feel that we really need some explanation from the Department to Justice about the handling of this case, and it really ought to come from fairly high up. If I am not mistaken, the Attorney General might feel that it is his responsibility to respond to those questions.

Mr. **Helmer**. Representative Kindness, I know personally about your reputation for looking out for your constituents, and although neither Mr. Gravitt nor I are constituents of yours, we know that you are very familiar with the Cincinnati area, and the fact that there are thousands of General Electric employees who live in Cincinnati and in your district, and we appreciate your concern for this matter.

All that Mr. Gravitt has ever asked is an opportunity for somebody, some government official, who is concerned, to listen to his complaints, and to listen to his charges. He has been prevented so far from doing that in the courts, through the efforts of the Justice Department. He has been prevented from doing that to the Justice Department. Those are two branches that he has gone to. You are the third, and we do appreciate your willingness to listen to his particular complaints.

Mr. **Kindness**. Was the criminal case ever presented to a grand jury to your knowledge?

Mr. **Helmer**. It is my understanding that there was testimony taken by a grand jury concerning this matter. I do not know who testified but I do know who did not testify. Mr. Gravitt and the other foremen who were instructed to alter vouchers were never called to testify.

Mr. **Kindness**. Do you know the approximate time of that grand jury proceeding?

Mr. **Helmer**. Yes, sir. I believe it was taking place in the late summer months of 1985, August-September, in that neighborhood.

Mr. **Kindness**. Thank you. Thank you, Mr. Chairman.

Mr. **Glickman**. Thank you.

I think that during the time that we are on break, I think if staffs are not similarly on break they ought to pursue this matter, so that when we come back the following week we may feel compelled to have an additional hearing on bringing the Justice Department to taik about your particular case with everybody else as well. Mr. Berman.

Mr. **Berman**. There are, as Mr. Kindness said, a number of questions that I would be interested in asking, but for purposes of getting through this hearing I won't ask any at this time.

Mr. **Glickman**. Mr. Brown.

Mr. **Brown**. Thank you, Mr. Chairman.

Mr. Helmer, help me understand, if you would. Did I understand you to say that when the civil side of the Justice Department got involved in this, that their first action was to request not just a delay but to request that the effort to obtain evidence not go forward?

Mr. **Helmer**. That is correct. We filed the complaint. It is my practice to file discovery requests with the complaint, which is permissible to do, and we served massive interrogatories, document requests, and notices for depositions which were in essence a blueprint telling you where the bodies were buried, and we did serve those with the complaint. The Justice Department's first actions were to request that the court instruct General Electric that it did not have to respond to any of those discovery requests.

Mr. **Brown**. Did the Justice Department offer any explanation as to why the discovery process should not go ahead, or they didn't want it?

Mr. **Helmer**. Yes, they did. It is my understanding that their belief was that if discovery was going ahead on the civil side, that that would permit General Electric's attorneys to discover what the Government was doing on the criminal side, and that that was the reason they gave as to why no discovery should go forward until after the criminal investigation was completed.

Mr. **Brown**. What are the consequences if you find out, if the civil side finds out evidence that the criminal side may have found out? Does this prejudice the case in some way?

Mr. **Helmer**. Not at all, but it may give General Electric's employees or officials some advance warning of indictments or criminal proceedings that the Government may wish to take. Now, as it turns out, no such indictments were returned, so that the whole matter was sort of academic. My main problem and concern was that no civil discovery was ever conducted. No witnesses were ever put under oath and asked some very tough questions, as to how far up the chain of command this fraudulent scheme went, and further, that the Justice Department made no effort to even obtain the fruits of the criminal investigation, which they are by statute prohibited from having unless they make a specific request to the court, which they did not do.

Mr. **Brown**. If I understand what you have said, the criminal side of the Justice Department decided not to proceed, or has not gone ahead with the criminal side. Once that decision was made, did the civil side then want to proceed with the discovery?

Mr. **Helmer**. No, the civil side then solicited from General Electric a settlement proposal. The settlement proposal was for General Electric to pay $234,000 to the Treasury of the United States. There was no further negotiation. There was no counter offer from the Justice Department. That was GE's offer that the Justice Department took.

Mr. **Brown**. Let me summarize this so I have got it clear ly in mind. The Justice Department stopped the discovery process, did not try and obtain under proper channels the evidence that the criminal side had developed, proceeded to settlement without ever developing the evidence, even though the criminal side had now closed its efforts, and has actively tried to coerce your client into not pursuing this?

Mr. **Helmer**. It has threatened Mr. Gravitt and his counsel that if they pursue this matter, consequences—sanctions were the words that were used—will be taken.

Mr. **Brown**. I am not a criminal specialist, but is this anything less than an effort to cover up on the part of the Justice Department?

Mr. **Helmer**. I think your question answers itself.

Mr. GLICKMAN. Would you yield to me?

Mr. BROWN. Certainly.

Mr. GLICKMAN. The Philadelphia case where GE pled guilty, when did that occur?

Mr. GRAVITT. I think it was about 7 months after I filed my case, sir.

Mr. HELMER. He means when the indictments——

Mr. GLICKMAN. When were the indictments?

Mr. HELMER. The indictments were about 7 months after the qui tam action by Mr. Gravitt was brought, and that complaint, by the way, alleges the identical scheme to defraud the Government that is set forth in Mr. Gravitt's complaint.

Mr. GLICKMAN. Do you know when the investigation began in the Philadelphia case?

Mr. HELMER. I do not.

Mr. GLICKMAN. Do you know if the investigation could have been precipitated in some way in the Philadelphia case by Mr. Gravitt's qui tam action in Cincinnati?

Mr. HELMER. I do not know that.

Mr. GLICKMAN. Do you know in the criminal settlement—well, it wasn't a criminal settlement but there was a guilty plea, wasn't there?

Mr. HELMER. Yes, and there were severe fines and penalies levied which GE agreed to and paid approximately $2 million.

Mr. GLICKMAN. In that plea bargain, do you know if there was or could have been any relationship between that particular plea and any other investigations then being undertaken by the Department of Justice?

Mr. HELMER. I was informed by Mr. Terlep that he was involved in that action also, and that is the extent of my knowledge.

Mr. GLICKMAN. The Philadelphia action?

Mr. HELMER. Yes sir. That is the extent of my knowledge of any connection.

Mr. GLICKMAN. But there was no separate civil action in the Philadelphia action as far as you are aware?

Mr. HELMER. I do not believe there was.

Mr. GLICKMAN. But I thought this Mr. Terlep was the qui tam man at the Department of Justice?

Mr. HELMER. That is correct.

Mr. GLICKMAN. That is the civil man, right?

Mr. HELMER. That is also correct.

Mr. GLICKMAN. But this is a criminal investigation. I thought they didn't have anything to do with each other?

Mr. HELMER. All I know is that he told me that he was involved in the Philadelphia matter. When I asked why is a false voucher in Philadelphia worth $2,000, and in Cincinnati it is worth zero, his answer, if you are interested in his answer, was that General Electric has gotten a lot smarter since Philadelphia.

Mr. GLICKMAN. Mr. Brown, do you have any more questions?

Mr. BROWN. No, thank you.

Mr. GLICKMAN. Mr. Boucher.

Mr. BOUCHER. Mr. Chairman, I don't have any questions, but based on what we have heard here today, it would seem to me to be very appropriate for this subcommittee to have hearings focusing on the Justice Department's action in this case, in delaying the qui tam litigation, and also in attempting to settle the case for about one-tenth of what the penalty otherwise could have been. I would hope the committee would do that.

Mr. **Glickman**. I think that is what our intention is right now. When do you expect the sixth circuit to rule on the issue of the proposition of your client's interest in the qui tam settlement?

Mr. **Helmer**. The answer is a little complicated, but let me see how well I can do.

Judge Rubin ruled that he would not accept the Government and GE's dismissal of Mr. Gravitt's qui tam action. He vacated that. However, he said he was not sure of the extent of his jurisdiction to hold hearings on the fairness of the settlement and he, through a procedure called a 1292(b) appeal, certified that for an interlocutory or special appeal to the sixth circuit court of appeals. So, in other words, Mr. Gravitt's case is still pending before Judge Rubin, but this one issue of Judge Rubin's jurisdiction over determining the fairness of the settlement he has asked the sixth circuit to look at.

Mr. Gravitt and I have filed a brief with the sixth circuit asking them to entertain the special appeal as has General Electric and the Government. We have all taken very different positions but we essentially all asked the sixth circuit to look at it. All of the briefs were filed as of yesterday, and the sixth circuit's staff has informed me that it will take approximately 2 months for the court to determine if they will even accept the appeal. The appeals court must first determine if it will accept the appeal. If the appeal is accepted, the court will then set up a briefing schedule.

Mr. **Glickman**. But, again, that is just strictly a jurisdictional issue will be decided?

Mr. **Helmer**. Yes, sir.

Mr. **Glickman**. And if it is decided that Judge Rubin doesn't have the jurisdiction, then what happens?

Mr. **Helmer**. If he doesn't have the jurisdiction, the General Electric Co. and the Government can go off somewhere and do whatever they please. It is Judge Rubin's view, I believe, that that would not be in the best interests of the citizens of the United States, but because this is the first time this issue has come up, even though the statute has been around since 1863, it is the first time this issue has come up, he has asked for guidance from the court of appeals.

Mr. **Glickman**. I want to tell you how much we appreciate your testimony. I would appreciate it if possible that you. Mr. Helmer, keep in contact with majority and minority staff on this as they will be working on this issue during the next 10 days, and they will contact you, I am sure.

Mr. Gravitt, I think you have performed a great service for your country, and you may in fact prevent future things like this from happening ever again, in light of the fact that perhaps Congress will pass legislation dealing with the issue. And even if we don't for some reason, the oversight that we have and will continue to do I think will be of immense benefit. But I think that we can legislatively take some steps to prevent this thing from happening, and the committee appreciates very much your being here.

Mr. **Gravitt**. Thank you, sir. It is an honor.

Mr. **Glickman**. Let me just ask you one question. Have you testified before the Senate committee?

Mr. **Gravitt**. Yes, sir.

Mr. **Helmer**. We testified before the Senate, though much earlier in 1985, before 90 percent of the developments that we have revealed to you occurred.

Mr. **Glickman**. So the settlement information was not an issue?

Mr. **Helmer**. Not before the Senate. Nor was the Government's position concerning qui tam actions. It was just simply the need for protection for a whistle-blower.

Mr. **Glickman**. Thank you both very much.

Our next witness is John Phillips, Executive Director, Center for Law in the Public Interest.

TESTIMONY OF JOHN PHILLIPS, EXECUTIVE DIRECTOR, CENTER FOR LAW IN THE PUBLIC INTEREST

Mr. **Phillips**. Thank you, Mr. Chairman.

Mr. **Glickman**. Mr. Phillips, it is a pleasure to have you here. Why don't you proceed.

Mr. **Phillips**. Thank you, Mr. Chairman.

I have submitted a fairly extensive testimony commenting on the details of the proposed amendments to the False Claims Act, and I will not belabor those points with this Committee today.

I would just like to summarize some of the points that I did make in that testimony, and provide some background of our involvement.

We became interested in the False Claims Act about two years ago, in fact I think Mr. Gravitt and his counsel, Mr. Helmer, learned of existence of the law in part partly through our efforts to locate counsel for a person in Ohio—not Mr. Gravitt—who needed a lawyer to advise him of his rights.

This law is a very obscure one. Most people, most lawyers are unaware of it. We became aware of it approximately two years ago when many of the disclosures were being made about fraud against the Government by various people, some of whom were anonymous, in southern California, many of whom worked for defense contractors. They were troubled over what they personally saw taking place within these defense industries, and wanted to know what remedy if any was available to them. As a result of those inquiries made of us and our organization, I began to do research about two years ago, and discovered this act. This research was done to enable us to advise them of what they may be able to do to protect themselves.

In doing that research, I think we had read every case, critiqued every point of contention contained in the False Claims Act, tried to look at its weaknesses and see how it could be strengthened. It is clear to us that the law in its initial purpose is simply not being fulfilled today, and the fact that virtually no actions have been brought in the last several decades is the strongest evidence of that. As others have testified before, the act was really viscerated in 1943 by amendments made that were well intentioned, but had the effect of undercutting the law substantially, and creating major hurdles in the way.

Before those 1943 amendments you had the situation that could occur where a person simply piggy-backed on a criminal investigation conducted by the Government, rushed to the court house, filed a civil lawsuit under the False Claims Act, providing no new or different information and claiming that under the act they had a right to keep a percentage of the recovery.

Now, nobody really wishes to encourage that kind of litigation. The amendments enacted in 1943 put a provision in there that stated that the action, when filed, must be based on information not in the possession of the Government at the time of filing. Court cases subsequent to that amendment have construed that provision all over the board, and it has essentially become a major deterrent to filing actions at all.

You heard Mr. Gravitt's testimony and his counsel how a short four-paragraph letter sent by someone else before Mr. Gravitt containing no specifics is being relied upon now by the Government as an absolute bar to Mr. Gravitt being able to pursue the case where he has provided extensive and detailed information.

When I advise people and others as to whether they should pursue the claim I must in good conscience tell them of all the major hurdles they will face especially the risk of retailiatory action by employees.

There are not many Mr. Gravitts out there who are willing to risk their jobs and their livelihood, because that is really what is at stake here when they step forward and claim that their employer is engaged in fraud against the Government.

As astounding as it may seem, there is absolutely no protection in Federal law that would provide any relief or remedy for a person like Mr. Gravitt who says he can prove and demonstrate that the company he is employed by has engaged in fraud against the Government and that his employer has tried to make him an active participant in that fraud.

There is a law on the books on the Federal side that protects Federal employees, but not people like Mr. Gravitt who work for private industry. That is the absolute minimum guarantee that must be provided in this legislation. Of course, the first thing they are concerned about is what is going to happen to them. All I can tell them is that they may suffer the same fate as a Mr. Gravitt. That is not very comforting to know they are likely to be fired because that has been the history in this country of people within the industries who have pointed the finger of fraud and abuse against their employers.

So, the amendments contained in your bill deal with that issue, and I think are an absolute necessity to encourage somebody to take those personal and professional risks.

The problem of fraud against the Government has been discussed a lot, especially in the defense industry, but this law, of course, applies across the board. Based on our experience, fraud of this type appears to be widespread and institutionalized and this act can only work if it gets the active knowledge and in many cases, participation of the people who work within these industries.

There is a conspiracy of silence that exists and you talk to them and they say, what has come forth so far is so small compared to the real problem out there. They are the people who are on the front lines, who know about the mischarging, and which is a common practice, especially among defense contractors, but they will not take the personal and professional risks of bringing that to the attention of Government agencies or their superiors within the company for obvious reasons.

Only if you are able to enlist the support of those people who don't like being placed in that position, who don't like really being unpatriotic, because that is essentially what they are being forced to do to participate in stealing against their Government. Unless some tools are created by this law to give them the proper incentives to step forward and some protections once they do so that they don't suffer the same consequences of Mr. Gravitt, this law will never really be effective.

It needs to be updated and brought into the 20th century and 21st century as we look ahead.

The four points which I would summarize that are important features of your bill that must be dealt with is first this question about the Government having the knowledge already or possessing the information at the time the lawsuit is filed. That has got to be narrowed, more specifically defined; yes, you want to deal with the situation where the person is bringing nothing to the table, is advancing no new information but you don't want to have a law that would allow the Government or the contractor who is typically the person that raises this defense, say, well, in fact back in the bowels of the bureaucracy certain documents were filed that if these documents were analyzed they would find evidence of fraud are contained in those files.

No one knows about it, it just exists.

That is the defense that has been used successfully in the past. That language must be changed in your bill, and the language contained in the bill now will correct that.

It will keep pressure on the Government. We have heard stories about the Justice Department and their failure to proceed.

That is not an uncommon practice for a variety of reasons. The Government lawyers are typically overworked, they have many matters pressing, it is a matter of priorities, they simply don't have the resources to handle many cases. They have the same budgetary constraints of all Government agencies.

Unless there is pressure on the side of bringing these actions, many of them don't get the priority they should.

I think historically within the Justice Department in Washington until perhaps recently, those who pursued a career handling these types of cases found themselves in the backwater of the Justice Department. It was never a place that was an opportunity for real career advancement. They say that is changing today but I am not so sure.

The other thing that must be done is to permit the person bringing the action to play an active role in pursuing the case to keep the pressure on the Justice Department. We have heard very graphic and dramatic testimony today of exactly why that is needed. If Mr. Gravitt and his counsel had been permitted to go forward and engage in discovery, none of what he described would have happened.

Much would have come to the surface that otherwise would stay beneath the surface. Once that information is before the court, there is no sell-out settlement that can be presented to a court to be approved with that information available and developed where people are put under oath to get to the bottom of it.

You should permit the party to have a role. If the Justice Department comes in and takes the case over, of course they are going to have the major role in pursuing the case. They will be in the driver's seat. But the law as currently drafted says if the Government takes over the case, you are virtually completely pushed out of the case. You have no available role to play whatever.

That should be changed to permit, participation similar to intervention today under the Federal rules, to allow that person to play an active role. Not an intrusive role. And if for any reason that person interferes with the Government's investigation, there are opportunities available for the Justice Department to go to court to limit their participation.

The fourth item, I think, necessary is to provide some minimum guarantee of recovery for a person who brings the action. Right now the law gives no such guarantee. It says you can provide up to a percentage, 10 percent, in Mr. Gravitt's case, of the recovery. You should provide a minimum guarantee and you should provide for attorney's fees paid by the defendant if a successful conclusion is brought to that litigation.

Offer the incentive to the lawyers to go out and bring these cases. They are only going to pursue good cases that have strong evidence that suggest fraud.

The good thing about this bill that it contains marketplace incentives, it encourages people because they want to do their patriotic duty first, but they also have a substantial stake in the recovery. Those incentives are important to get people to take the risk, to step forward and put the pressure on the government and on the defense contractors or any other contractors doing business with the Government, to be accountable for their conduct.

The objections I have read, some by the Justice Department, I think can be easily dealt with. I do not believe they have a serious problem there. The question of litigation by committee was raised yesterday by the Department. They want to be totally in the driver's seat. Well, I don't think they should be totally in the driver's seat, because we will get too many results similar to what we have heard today from Mr. Gravitt.

There should be an ongoing role for that party to play that brings the action initially.

Frivolous lawsuits is something you always hear any time you create a law that gives a party the right to go to court.

There are already enough rules and powers that courts have operating under the Federal rules that would penalize lawyers and litigants invoking athe judiciary machinery in a frivolous way. I can tell you based on my experience in Federal court, that lawyers would be most reluctant to bring a case before a Federal court where they cannot substantiate or have some reasonable grounds to back up their allegation.

If it is a frivolous case brought for harassment purposes, they are only inviting sanctions, fines and penalties against themselves. Courts and judges have shown in recent years a willingness to level such fines, in fact Chief Justice Burger just recently announced or stated that the analysis recently in the last several years has shown judges to be willing to take on lawyers and litigants who improperly invoke Federal machinery.

We have heard complaints by Justice that criminal investigations could be interfered with. There are ways of handling that to protect their right to go forward on a criminal basis. One approach is in the existing Senate version you may look at. I don't believe it to be a serious problem based on my knowledge of the practice. But if that is the Justice's concern there is a way of dealing with that, so their investigation in no way would be compromised.

The Justice Department needs all the help it can get. It is understandable they don't want pressure brought from outside to intrude into what they consider their prerogatives. But they ought to welcome this. This is a partnership. People want to participate and see that this fraud is stopped.

Only if you get that participation will you have a real effective disincentive for the contractors not to do it in the future.

The good thing about this law is it is action forcing and it is self-executing. It does not create a new bureaucracy, not one person is added to the payroll. If a case is brought successfully, everybody benefits. There is no downside to this. The only party against this is the party engaging in fraud.

I am sure we will see a lot of heavy lobbying on the other side, because they should fear this. This will do more done if there is publicity surrounding passage of this law and people understand the rights available to them within these industries, I think you will see more to ferret out fraud in such a way that it will act as such a major deterrent to these contractors to know they can simply not expect their employees to participate in this conspiracy of silence again in the future.

They will be exposed. They better not take the risks. Right now those disincentives are not there. It is business as usual and the same mischarging you heard about today goes on day in and day out. There is no way for the auditors to check it. The auditors are looking for a paper trail. If the trail is there, they are satisfied. They don't go in and interview and investigate and find out and ask Mr. Gravitt or the other foremen in his shop, did you engage in mischarging? That simply doesn't occur.

That is why you need the support of these people like Mr. Gravitt and others, and there are many out there who would be very anxious to step forward and feel they are doing a patriotic duty of exposing fraud.

Thank you.

[The statement of Mr. Phillips follows:]

Phillips

SUMMARY OF TESTIMONY OF JOHN R. PHILLIPS REGARDING H.R. 3317 AND H.R. 3828 (AMENDMENTS TO THE FALSE CLAIMS ACT) BEFORE THE U.S. HOUSE OF REPRESENTATIVES COMMITTEE OF THE JUDICIARY, SUBCOMMITTEE ON ADMINISTRATIVE LAW AND GOVERNMENT RELATIONS

February 6, 1986, at 10:00 a.m.

With these amendments, the False Claims Act can become once again an important tool to combat fraud against the government. Amendments to the False Claims Act made in 1943 had the unintended result of greatly diminishing and undercutting its effectiveness. The procedural and substantive adjustments proposed by H.R. 3317 and H.R. 3828 will update the 123 year-old law and apply marketplace incentives to ferret out fraud and overcharges against the government. And it will not add one single employee to the government payroll.

These amendments will: protect employees against retaliation by their employers when they file charges under this Act; ensure that once allegations of fraud are disclosed that an investigation will be conducted and appropriate remedial action taken; provide for a minimum amount of recovery for the person responsible for exposing the fraud. Taken together, the False Claims Act as amended will provide strong incentives for employees of government contractors and others to expose corruption and fraud against the government.

These proposed amendments will make the False Claims Act self-executing and self-enforcing, calling upon the American people to join in the fight to root out fraud against the government. And it will provide a powerful disincentive to some government contractors who have, in the past, forced their own employees, by a conspiracy of silence, to be reluctant witnesses of fraudulent and illegal schemes designed to overcharge the government. The only people or companies who will be hurt by these amendments will be those who cheat the government.

TESTIMONY OF JOHN R. PHILLIPS
REGARDING H.R. 3317 and H.R. 3828
AMENDMENTS TO THE FALSE CLAIMS ACT

BEFORE THE U. S. HOUSE OF REPRESENTATIVES
COMMITTEE OF THE JUDICIARY, SUBCOMMITTEE ON
ADMINISTRATIVE LAW AND GOVERNMENT RELATIONS
February 6, 1986, at 10:00 a.m.

LG158#3

I. INTRODUCTION

My name is John Phillips, and I am an attorney and co-director of the Center for Law in the Public Interest, a non-profit charitable organization based in Los Angeles that provides legal representation without charge to various unrepresented interests.

We first became interested in the False Claims Act several years ago when, after public disclosure of fraudulent overcharges within the defense industry, the Center received anonymous calls from employees of defense contractors who were aware of improper and illegal practices, but were not sure what they should do or where they should turn with this information. These potential "whistleblowers" did not believe they could go to the government -- they lacked confidence that anything would be done; nor could they go to the top officers of their employers for fear of retaliation. As a result of these calls the Center conducted research into the area of legal rights and remedies available to such people and discovered a little used 122-year old Act, the False Claims Act.

My testimony is limited to the amendments to what is commonly referred to as the qui tam ("he that sues as well for the state as for himself") provision of the False Claims Act contained in H.R. 3317 and H.R. 3828.

II. BRIEF BACKGROUND OF THE FALSE CLAIMS ACT

The original False Claims Act was passed in 1863 to combat the widespread fraud, corruption and misuse of federal funds that occurred during the Civil War. At that time, the

F.B.I. did not exist and the U.S. Attorney General's staff was very small. The Department of Defense (then the War Department) lacked investigators to check on its various contractors and suppliers. Thus, the Government was largely dependent upon information received from private individuals concerning false claims or fraud against the Government.

The False Claims Act created civil liability for persons who made false claims against the federal government. The Act provides that any person who knowingly makes false claims against the Government shall be subject to a $2,000 civil penalty and double the amount of damages sustained.

One portion of the Act, referred to as the qui tam section, was designed to encourage individuals to come forward and bring suit on behalf of the Government against the perpetrators of the fraud. In return for bringing suit, the person received half of the civil penalty, half of the damages, and all court costs.

More than four decades ago a court decision in 1943 resulted in amending legislation that severely undercut the impact of the False Claims Act. In 1943, the Supreme Court ruled in United States ex rel. Marcus v. Hess that a private person could sue under the Federal Claims Act on behalf of the U.S. Government, even though the action was based solely on information acquired from the Government. Following that decision, numerous "parasitic" law suits were filed based solely on information they obtained from court indictments, newspaper stories, and congressional investigations, without providing any new information. While the literal wording of the Act permitted this type of action, it was obviously not consistent with the intent of the Act.

In the same year, in reaction to these suits, Congress amended the statute. The amended Act provides that the court shall dismiss an action brought by a person on discovering the action was "based on evidence or information the Government had when the action was brought." The *qui tam* plaintiff's recovery was also changed. Instead of receiving one-half of the recovery, the plaintiff was entitled *to up* to 10% of the recovery (with no guarantee of any recovery) if the Government intervened in the suit. If the Government did not intervene in the suit, the plaintiff was entitled to up to 25% of the recovery.

III. BENEFITS OF THE EXISTING FALSE CLAIMS ACT

The False Claims Act is the best tool available to private citizens for attacking an important problem plaguing the nation today -- namely the millions of taxpayer dollars that are paid out to private corporations based on fraudulent claims made on government contracts. The purpose behind the enactment of the False Claims Act in 1863 -- to encourage individuals to aid the Government in ferreting out fraud against the Government -- is even more critical today, where the federal government is spending billions of dollars on federal contracts with private corporations in areas such as defense, aerospace, medicine, and construction. All one has to do is read the headlines to know mischarging practices are prevalent in the industry. The Justice Department does not have unlimited resources and should benefit from the additional non-governmental resources brought to bear to develop and pursue instances of false claims submitted to the government. Moreover, the critical element -- knowledge of such practice -- is uniquely in the possession of people within the industries which have government contracts. The False Claim Act encourages those people to reveal such information.

The False Claims Act benefits everyone: The government, because it recovers the amount of damages sustained because of the false claim; the person bringing the suit, because he can receive a substantial monetary award for doing his patriotic duty of exposing fraud against the government; and taxpayers, because they see that their dollars are not being squandered by fraudulent practices perpetrated by companies doing business with the Government.

A False Claims suit brought by an individual puts the machinery of the courts in motion to determine whether false claims have occurred. Once the suit is filed, the government cannot ignore the charges for political or administrative reasons, including lack of resources or low priority.

IV. DISADVANTAGES OF THE EXISTING FALSE CLAIMS ACT

Despite its wide application, the existing Act is not utilized by potential plaintiffs because it is flawed both substantively and procedurally, creating problems for both individuals and the U.S. Attorney's Office. First, the individuals who have the information of fraudulent practices are very reluctant to risk their jobs and livelihood to expose fraud without a guarantee of adequate protection. There are many risks and personal sacrifices involved in filing a False Claims Act suit, or testifying in such a suit. These risks include, first and foremost, being fired by an employer, being harassed or threatened by employers or co-workers, and if fired, being blackballed from within the industry in which they work.

These fears have a basis in fact, for "whistleblowers" have historically not been treated well within our system. They have divulged their information and then lost their jobs. Even if they were able to bring suit against their employer for a retaliatory firing, the cases might take years to prosecute and are a big drain on personal resources, without any guarantee of success.

In order for the False Claims Act to be truly effective in encouraging individuals to expose fraudulent claims against the Government, the Act must contain both employment and personal safeguards for those persons filing the suits or testifying in such suits. Moreover, the Act must contain strong measures to deter and punish an employer who violates the Act and retaliates against an employee for fulfilling his patriotic and ethical duty.

Another problem with the False Claims Act as presently written is that some provisions create harsh and unreasonable obstacles for both the individual plaintiff and the Government. These provisions effectively defeat the objectives of the Act and create disincentives for an individual to file suit. These obstacles include the following:

-- the opportunity for an individual's suit to be dismissed if the Government already has the information upon which the suit is based, even if the information is not being acted upon or analyzed in any way. This provision is unclear and courts have interpreted it differently. For example, a suit could be dismissed if the information was in unanalyzed storage files of unconnected government agencies.

-- the chance that an individual who files a case can be completely removed from the suit if the U.S. Attorney enters the case, leaving the individual unable to ensure the case's effective and speedy prosecution on its merits;

-- the chance that an individual plaintiff will receive a small percentage (or even no percentage) of the recovery, due to the completely discretionary nature of the award and the fact that the person must pay the attorneys' fees out of the recovery amount awarded;

There is also a need to amend the Act to provide the Government with more flexibility in a case. The existing Act provides that once the U.S. Attorney's Office decides not to enter the case, the case is completely prosecuted by the individual filing the suit. What if new material information is uncovered which was not known by the Government when making its decision not to enter the case?

The proposed amendments to the False Claims Act contained in H.R. 3317 and H.R. 3828 would remedy these unintended disincentives in the Act and fulfill the true purpose of the Act -- to encourage people with knowledge of false claims to step forward and see that the claims are prosecuted on behalf of the United States government.

LG158#3

V. EFFECT OF H.R. 3317 and H.R. 3828 AMENDMENTS

(A) Protection of Plaintiff and Witnesses

The existing False Claims Act does not provide any protection whatsoever for the person bringing a lawsuit on behalf of the Government. After filing a suit, such person might be immediately fired by his employer, threatened or harassed by supervisors or co-workers, and blackballed from the industry in which he works. Thus, most individuals would be very reluctant to risk their jobs, their livelihood, and their personal security to expose either through filing a lawsuit or providing testimony the fraudulent practices of their employer or former employer in a False Claims Act suit.

The proposed amendment is essential to help alleviate the fears of a potential plaintiff or witness in a False Claims Act suit, and is reasonable and just given the many risks the plaintiff assumes in stepping forward. The effect of the proposed amendment is twofold: first, it will encourage a person to do his patriotic duty and expose a false claim with reduced fear of being left stranded without a job or personal security; and second, it will allow punishment - and hence deterrence - of an employer who engages in retaliatory action against such person.

The new provision carefully details examples of possible job discrimination outside of employee discharge, including threats, demotions, suspension, and harassment. The examples are given to deter the situation where an employee isn't fired outright, but is treated in an inferior manner by his company. The amendment also protects witnesses and those assisting in a False Claims Act investigation or lawsuit who might otherwise be afraid to testify on behalf of the prosecution.

The phrase "discriminated against... in whole or in part..." is included because an employer might offer another reason why the employee was fired, when in fact, the initiation or participation in a False Claims Act suit was an element in the employee's discharge.

The relief portion is designed to make the person whole again, whether that includes restitution with full seniority rights, back pay with interest, or compensation for any special damages sustained as a result of the discrimination.

To resolve the problem of a potential plaintiff being unable to bring a suit because of prohibitive attorneys' fees, the provision provides litigation costs and reasonable attorneys' fees as part of the plaintiff's recovery.

The provision also provides stiff penalties against employers found guilty of retaliatory action. An employer is liable to the employee for twice the amount of back pay and special damages, and if warranted, is liable for punitive damages.

This new provision would go far in ending the "conspiracy of silence" which often surrounds a company and intimidates its employees into compromising their ethical standards.

LG158#3

(B) Government "Acting" on Information

The purpose behind the existing Section -- 3730 (4) was to eliminate the former practice of "parasitic" law suits. Back in the early 1940s, private individuals were filing False Claims suits based on information they obtained from court indictments and congressional investigations without providing any new information. In 1943, the section was amended to prevent this abuse by allowing the court to dismiss an action brought by a person on discovering the action was "based on evidence or information the Government had when the action was brought."

The serious problem with the existing language is that it places no responsibility on the Government to have developed the information or evidence in any way before the private citizen's suit is completely precluded. The evidence can just exist in a government file or within several disconnected government agencies without any analyses or connection being made for the suit to be dismissed.

The proposed amendment strikes a balance between closing the loopholes which lead to "parasitic" lawsuits and more reasonably and clearly defining what information or evidence is sufficient to warrant a case's dismissal by the court.

Under the proposed language, if a person bases a lawsuit on information or evidence that the Government has already disclosed in a prior administrative, civil, or criminal proceeding, the person's suit is to be dismissed. Moreover, if a person bases the lawsuit on specific information disseminated by any news media or disclosed during the course of a congressional investigation, the person's suit is to be dismissed. In this way, a person is foreclosed from merely "piggybacking" their lawsuit on to a prior or existing investigation into the facts alleged.

On the other hand, the U.S. Attorney's office would not be granted unlimited time to investigate the evidence or information disclosed. If the Government has not initiated a civil action within six months of becoming aware of such evidence, the court shall not dismiss the action brought by the person. If, however, the Government has been diligently pursuing the information but still has not had sufficient time to investigate the facts and bring a lawsuit, the Government can be granted additional time by the Court upon a showing of good cause. This time limit assures the person who carried the burden of initiating the action that if the lawsuit has merit, it will proceed, despite the Government's reluctance to act on its information for whatever reasons.

(C) Active Involvement of Plaintiff

The existing language of the Act (Section 3730 (3) and (4)) present a harsh, ineffective and self-defeating "all or nothing" proposition both for the person bringing the action and for the Government. If the Government proceeds with the action within the designated time limits, then according to existing Section (3), the action is conducted only by the Government. Thus, the person who often faces substantial hardships and considerable personal risk in bringing the action is forced out of the suit entirely, unable to have any role to ensure that the case will be vigorously prosecuted.

The proposed language in Section (3) would allow the person who brought the action to continue in the action as a full party on the person's own behalf, even if the Government proceeds with the action. The government would have primary responsibility for prosecuting the case but the person would continue to have a direct stake in the outcome, ensuring that once the Government takes over in the case, the Government doesn't "sit" on the evidence, drag out the case, or let it drop for administrative or political reasons.

Since the person bringing the case often has risked their job and livelihood, if not his or her safety, in order to expose the fraud, it is only fair as a matter of public policy to allow the person to continue as a party to see that the case proceeds forward on its merits. Moreover, this furthers the primary purpose of the False Claims Act - to encourage private parties to expose fraud that they are otherwise discouraged from exposing. The Government, however, will not be bound by an act of the person bringing the action and will still be in the position of controlling the litigation.

(D) Guarantees of Monetary Awards

These provisions deal with the amount of recovery a person may receive for bringing a civil action under Section 3730. The amounts a court currently may award are quite undefined and discretionary.

In the existing Act, if the Government proceeds with the action, the person may receive "no more than 10 percent of the proceeds of the action or settling of a claim," if the

Government does not proceed with an action, the person bringing the action or settling the claim may receive no more than 25 percent of the proceeds of the action or settlement.

The problem with such an undefined and discretionary amount is that it discourages people from bringing a false claims action because there is no guarantee that they will be awarded anything even if there is a substantial recovery. There are many risks involved in bringing such an action. First, a person must find the courage and the confidence to step forward and personally testify to the fraudulent practices of his employer, for example. This can immediately lead to being fired from the job, being blackballed from the industry, and being harassed and threatened by employers and co-workers.

In addition, court cases generally take a long time to try and are fraught with continuances and delay tactics on the part of the defendant. The person bringing the case will be forced to spend a tremendous amount of time on the case, and assuming he is fired, must find alternate sources of income to support a family and/or himself. Thus, the case becomes a substantial investment of time, money, energy, and emotion.

If a possible plaintiff reads the present statute and understands that in a successful case the court may arbitrarily decide to award only a tiny fraction of the proceeds (or nothing at all) of the action or settlement to the person bringing the action, the person may decide it is too risky to lose a job over a totally unpredictable recovery.

The proposed amendments take into account the risks and sacrifices of the plaintiff and offer minimum monetary incentives to induce individuals to step forward and expose fraudulent practices. If the Government proceeds with the action within 60 days of being notified, the person bringing the action shall receive between ten and twenty percent of the proceeds of the action or settlement of a claim, based on having brought the important information or evidence to the Government's attention.

The setting of such a range is sensible and can be looked upon as a "finders fee" which the person bringing the case should receive as of right. The Government will still be more than made whole receiving between 80 and 90 percent of the proceeds based on double damages -- substantially more than the zero percent it would have received had the person not brought the evidence of fraud to its attention.

Additionally, if the person bringing the action substantially contributes to the prosecution of the action, the person shall receive at least 20 percent of the proceeds of the action or settlement. This award can be looked upon as a "performance fee" based on contributions made in the litigation itself. The more substantial award encourages the person to contribute and participate in the suit through his lawyers in a positive, constructive way and to keep the pressure on the Government to effectively try the case.

Where the Government does not proceed with an action within 60 days of being notified, the person bringing the action or settling the claim shall receive an amount not less than 25 percent and no more than 30 percent of the proceeds of the action or settlement. In this case, the person is principally responsible for the lawsuit and should be well compensated based on having the primary role of prosecuting the case. Another important change made in the existing provisions involves attorneys' fees awards. If the Government does not proceed with an action, under the existing Act, the person bringing the action may receive "reasonable expenses the court finds to have been necessarily incurred." No express reference is made, however, to attorneys' fees.

Assuming the case involves a defendant with substantial resources, the litigation will be hard fought, with the plaintiff facing a phalanx of well financed defendant's lawyers with motions, discovery disputes and continuances. In a case involving a $200,000 claim, for example, the attorneys' bills alone (based on hours spent) in a case such as this could easily reach $100,000 or more. Since under the existing provisions, attorneys' fees are to be paid out of a person's recovery, it works as a disincentive for persons to bring a suit involving smaller cases of fraud, i.e., cases of 1/2 million or less. In almost all cases a plaintiff will have to offer the lawyer a percentage of the recovery available to the plaintiff. If there is a formidable array of lawyers on the other side, the plaintiffs' attorney could be required to spend enormous amounts of time for a relatively small financial reward. This would discourage attorneys from agreeing to take the case even though there may be strong evidence of fraud. Thus, reasonable attorney's fees, as defined by the courts, should be paid separately by the guilty defendant and is a fair apportionment of the cost incurred in discouraging the illegally obtained money.

LG158#3

Under existing court procedures, these fees would be based on hours reasonably spent times a reasonable hourly rate.

In the proposed amendments, a person who contributes to the prosecution of the action along with the government, or who prosecutes the action alone, may receive an amount for reasonable attorneys' fees and costs awarded against the defendant.

These proposed monetary awards will serve two main purposes: to provide a person with the incentive to bring a false claims case against a powerful defendant with substantial resources, and to adequately compensate the person for all the resources expended during the course of prosecuting the case.

(E) Government's Ability to Re-Enter the Case

The existing provision of Section 3730 (2) (A) also works an extremely unreasonable hardship on the government, for it bars the government from entering the case if it does not enter by the end of the 60-day period. What if new material evidence comes to light after that period which would have altered the government's initial decision not to enter the case?

The most reasonable solution is to allow the government in such a case to enter so it can bring its considerable resources to bear on the case. This is especially true in a complex case with a great deal at stake, where the resources of the defendant are tremendous and the person initiating the action on behalf of the government is almost inevitably put at a great disadvantage. It is thus in the interest of justice to ensure that the government may enter the case when it knows of new material evidence which will expose the fraud and substantiate the claims filed.

The proposed amendment solves this problem because the government now has a chance to enter in the case at a later date even if it did not proceed with the action within the 60-day period after being notified, if it can show the court that it now has new material evidence or information it did not have within the 60-day period after notice. The limitation as to situations where the government has "new" material evidence is to assure that the 60-day limit for the government's initial decision whether to enter the case is meaningful.

While allowing the government to enter so that it can play a significant role in the case, the language also ensures that the person who bore the burden of initiating the case and developing it into a strong one is not just pushed aside. The status and rights of the person are retained and protected so that the person remains a formal party to the action.

V. CONCLUSION

Adoption of H.R. 3317 and H.R. 3828 will make available a new and significant tool to combat a serious problem facing the nation today -- fraud against the government. It offers this potential without any additional costs or additional government personnel and does not create any new government enforcement bureaucracy. It will be self-executing and self-enforcing, calling upon its own citizens to join in the fight to protect the public fisc. And, it will provide a powerful disincentive to government contractors who have in the past forced their employees to either witness or participate in fraudulent and illegal schemes designed to overcharge the government. The only losers from this amendment will be those who cheat the government.

LG158#3

Mr. **Glickman**. Thank you, Mr. Phillips. Why don't you stay there, we have a second vote here on the rule and we will be back in about 12 to 15 minutes.

[Recess.]

Mr. **Glickman**. I apologize for these delays, but they are unavoidable once we are in session; and it has taken a little longer than what we had anticipated.

Mr. Phillips, I think you were finished.

Mr. **Phillips**. Yes, I was. I had completed my statement.

Mr. **Glickman**. Let me ask you a couple of questions. How do you deal with the situation where the employee could be accused of retaliating against an employer or harassing an employer by filing a qui tam suit? Some critics have alleged this kind of thing would happen.

Mr. **Phillips**. I think there are very serious deterrents against such a person taking such action. First, to file a lawsuit presumbly you would have to retain counsel to review the act's requirements, make a determination based on the credibility of the information that he has and then be willing to file a Federal court action which is a fairly serious undertaking. If the counsel has any reason to believe that his motives are based on sour grapes or seeking retaliation with no foundation, with no basis in fact, I do not think many lawyers would be willing to take that risk because the authority of the judges today under existing precedent by the U.S. Supreme Court, the Federal rules, and others to impose sanctions against counsel personally for filing unsubstantiated charges like this is a strong deterrent—and it is happening more and more. I simply do not believe that filing such unsubstantiated meritless suits would be a problem. If it turns out to be a case without any substance, it will be treated in a very summary fashion and go no further. It is not much harassment, frankly, to a big company like General Electric to have a lawsuit with no basis filed against it. It can be handled quite quickly.

Mr. **Glickman**. You can also require, as I think the Grassley bill does, that the judge would award legal fees if the suit were filed frivolously.

Mr. **Phillips**. If it is for the purpose of harassment, the Grassley bill does contain such langauge.

Mr. **Glickman**. There is some way to statutorily contain it. One of the objections to the qui tam amendment has to do with the fact at the time the law was passed and amended there were no statutory inspector general as there are now, and the point seems to be the that Government has greatly increased investigatory resources and, therefore, these amendments are unnecessary. I wonder if you might respond to this as an option to the qui tam provisions.

Mr. **Phillips**. Admittedly the Government today is different than it was in 1863 when the bill was first enacted. However, based on my own experience with Federal prosecutors, Government investigators, to do the job that needs to be done here they simply do not have the resources if the fraud that is going on today came to the surface. It is not a way of really challenging their authority. It is a way of assisting them. They ought to view it as a partnership and an opportunity to encourage people who are on the front lines, people like Mr. Gravitt, to step forward with their information and to give them some incentive to do so. That is really what the purpose of this act is. They are not going to step forward today given the risks that they face professionally and personally unless they feel that there are some safeguards built into the bill that these amendments would provide.

I do know why the Justice Department would have some reservations about this bill, because they like to control their own dockets. They do not like a great deal of pressure being brought to bear on them. They do not like somebody, as in the case of Mr. Gravitt, saying you are not doing your job. They have got many cases to handle. They are always complaining about inadequate resources. They are the first to say we need larger budgets, but Gramm-Rudman is going to confront their staffs as well.

This is an opportunity without adding one more person to the Federal payroll of enlisting support of thousands of people in ferreting out fraud against the Government.

Mr. GLICKMAN. One of the things we would probably like to have for the record is the number of qui tam actions filed and the number of successful ones, you know, all the statistics on these. Do you have that information?

Mr. PHILLIPS. All I have is based on our own research which was based on reading the cases and interpreting the law over the past 123 years, and I can tell you there are relatively few. The Justice Department admitted, apparently in previous testimony and in talking to Mr. Gravitt's counsel, that there are very, very few of these actions filed. When Mr. Gravitt's suit was filed, the Justice Department people were quoted even in the press, I recall at the time, this is one of the first they had ever heard of. There are a few cases, one filed I think in Mississippi, much smaller in scale, but I do not have the specific numbers except the knowledge there are so few as to be totally insignificant, and that has been probably because the barriers and hurdles are so substantial to overcome.

Mr. GLICKMAN. There is the qui tam person at the Justice Department. We may be in a position to ask him.

Mr. PHILLIPS. He would probably know, but Mr. Gravitt's counsel said how many have been to trial since he has been there, 5 years, and he said zero.

Mr. GLICKMAN. The final question concerns the issue of the substantial award, substantial monetary award. I do not want to get into a situation where it looks as if for people doing their patriotic duty they are getting a substantial monetary award, but in the sense that I think with respect to the public they need to know both motives are there. They are both doing their patriotic duty as well as getting a substantial monetary award, but that second one does not far exceed the first one.

I wonder when you talk about the substantial monetary award how would you characterize that? As an incentive fee, a finder's fee, informant's fee?

Mr. PHILLIPS. You could characterize it in different ways. If the Government takes over the case, successfully prosecutes it with very minimum participation once having filed the case by the qui tam plaintiff, then I think you call it a finder's fee because they are the persons responsible for bringing the information to the attention of the Government and the Government then takes it from there. If the person plays a very active role in continuing the litigation, which is necessary frequently to keep the pressure on the Justice Department—and certainly in the case of Mr. Gravitt would have been very helpful, 2 years hence we would have found a lot more discovery having been completed and a lot more information disclosed—then I think that person should receive substantially more compensation and there is a discretionary amount, in a range, that a court has the authority to impose based on that amount of participation. But I believe it is very important there be a minimum a percentage that the person can realize as opposed to it being totally discretionary. And if you are completely subject to the discretion of a particular court, it is not inconceivable the person could have done all this with a successful outcome and then have very little or nothing to show for it.

It is important from the beginning to know that going into this, if they are successful, if their facts are well justified, they are going to be entitled to some compensation, that they may not find themselves at the end of that process with absolutely nothing. That could happen under the existing law and this bill will amend that.

Mr. GLICKMAN. Thank you for your testimony. I appreciate it very much.

[Information referred to above follows:]

U.S. Department of Justice

Civil Division

Office of the Assistant Attorney General

Washington, D.C. 20530

FEB 20 1986

Honorable Daniel Glickman
Chairman
Subcommittee on Administrative Law
and Governmental Relations
Committee on the Judiciary
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Following my testimony before the Subcommittee on March 5, 1985, the Subcommittee heard testimony from Mr. John Michael Gravitt and his attorney, Mr. James Helmer, as to the Justice Department's handling of the qui tam action which Mr. Gravitt brought against General Electric on behalf of the United States. Because Mr. Helmer's testimony contained serious misstatements as to the government's handling of this action, I would like to take this opportunity to set the record straight.

The instant action was brought under the citizens suit or "qui tam" provisions of the False Claims Act, 31 U.S.C. § 3730, by Mr. Gravitt against his former employer, General Electric. Let me state at the outset that Mr. Gravitt is to be commended for his actions in this case. By coming forward when he did, he helped to expose a conspiracy to falsify time cards and vouchers in the DMO machine shop at G.E.'s Evendale plant, which prevented the government from gaining a true picture of labor costs in that shop.

Notwithstanding Mr. Gravitt's help in exposing mischarging in the DMO machine shop, Mr. Gravitt and his attorney evidently remain under a severe misapprehension as to the true facts of this case despite the extensive briefings they have received by Justice Department and FBI personnel.

First and foremost, after an estimated 5,000 hours of investigation, the government has concluded that it has suffered no measurable monetary damage due to the mischarging in the DMO shop. While there was undoubtedly a conspiracy to mischarge hours systematically in the DMO shop, our investigation led us to conclude that the mischarging was done in an effort to meet internal G.E. production guidelines, and not to defraud the government. In fact, it appears that the United States was actually undercharged due to this conspiracy. In effect, the conspiracy Mr. Gravitt uncovered was designed to defraud General Electric and to protect the jobs of employees in the DMO shop, not to defraud the government.

More seriously, upon reviewing the transcript, I see that Mr. Helmer left the Subcommittee with the impression that in our handling of the civil suit, the Department failed to conduct an adequate investigation of this matter, and that in reaching a settlement with G.E., we simply accepted their view of the facts and entered into a "sweetheart" deal. Nothing could be further from the truth.

Almost a year before Mr. Gravitt filed suit in October 1984, his allegations had been brought to the attention of the Defense Contract Audit Agency (DCAA) by General Electric after it had conducted its own internal investigation prompted by Mr. Gravitt's letter to them of June 30, 1983. DCAA reviewed G.E.'s internal investigation and the work papers underlying that study. They determined that the government had suffered no loss as a result of the scheme, and were satisfied that G.E. was taking adequate steps to correct the problem. In light of those findings, DCAA determined not to refer the matter for prosecution.

After Mr. Gravitt's suit was filed, the United States Attorney in Cincinnati took over the action. Due to the seriousness of the allegations in Mr. Gravitt's complaint and the accompanying disclosure statement, and the fact that we had what then appeared to be a similar action pending against G.E. in Philadelphia, the investigation was reopened for both criminal and civil purposes by the United States Attorney. As is our practice in such cases, we sought a stay of the civil proceedings so that General Electric would not have the opportunity to use the liberal civil discovery rules to discover aspects of the government's criminal investigation.

Over the course of that investigaton, which lasted from approximately December of 1984 to August of 1985, the FBI, the Air Force Office of Special Investigations and the DCAA interviewed approximately 35 witnesses and, with the cooperation of G.E., conducted an extensive audit of the activities of the DMO shop from 1981 through 1983. Of the approximately 60,000 time cards generated during that period, we selected for careful review by government auditors a sample of approximately 12,500, representing all the timecards from six non-consecutive months. Where necessary, special infra-red analysis was used to determine how timecards had been altered. In summary, we determined that for every five hours mischarged on the altered cards, one was mischarged to the detriment of the government, two were mischarged to the detriment of G.E. and two had a neutral impact. It was on the basis of this investigation that the Department, and all of the investigating agencies, concluded that the government had not been defrauded by the scheme.

Further, because this investigation was conducted before any grand jury testimony was taken (that did not occur until August or September, 1985), the fruits of the investigation could be and were, in fact, shared by both criminal and civil attorneys in the Department. In short, the strictures of Rule 6(e) of the Federal Rules of Criminal Procedure, as interpreted by the Supreme Court in United States v. Sells Engineering, Inc., 103 S. Ct. 3133 (1983), did not impede the Civil Division's evaluation of this case. We did not move for a court order for access to the grand jury testimony for the simple reason that it was not necessary; the prior investigation was more than adequate. Our conclusions in this regard are buttressed by the fact that the prosecutors in the Department declined to bring criminal charges against G.E. or the individuals involved.

Thus, by September of 1985, we realized that Mr. Gravitt's charges related to a serious situation involving mischarging in the DMO shop, but one in which the United States had suffered no measurable damage. Moreover, in both the criminal and the civil cases, we would have been required to prove that G.E. intended to defraud the government by the scheme. Obviously, this was not a case which we believed we could prove. Nevertheless, because some of the Evendale plant's monthly claims on government contracts could technically be considered false because they did not present a true picture of the work being done in the DMO shop, even though their falsity resulted in a net undercharge, we were able to use the False Claims Act's civil penalty provision aggressively in settlement negotiations, which ultimately yielded the $234,000 settlement currently at issue.

Under the False Claims Act, the government is entitled to double its actual damages, plus a $2,000 civil penalty for each false claim or false statement submitted to get a claim paid. In this case, we determined that there were 303 monthly billings by the Evendale plant which included DMO work for the relevant period. Using the ratio of overcharges to undercharges developed through the audit of the six-month sample, DCAA was able to estimate that 117 of the 303 claims were likely to have resulted in falsely inflated charges to the government. The settlement amount reflects a $2,000 forfeiture for each of these claims.

Mr. Helmer's apparent confusion arises from his erroneous belief that because the government received a $2,000 civil penalty for each false timecard in an apparently similar case against G.E. in Philadelphia, it should have received a similar award in this action. (He calculates that the government should get a $2,000 forfeiture for each incorrect time card, or a total of $36 to $48 million.) However, in the Philadelphia case the criminal action was based upon G.E.'s actual submission of the false timecards in connection with a post payment audit of claims. G.E. pleaded guilty to submitting four false claims and making 100 false statements to the government by presenting 100 false timecards in connection with the audit. In their effort to resolve their civil liability under the False Claims Act, G.E. offered to pay the government $1.9 million. Their calculation apparently included doubling of the actual damages which the government suffered as a result of the scheme, plus a $2,000 civil penalty for each of the false statements and claims.

Unlike the Philadelphia case, in the present case, G.E. never presented the false timecards to the government representing them to be true. When G.E. management learned of the falsity of the timecards by way of Gravitt's letter, they informed DCAA. Therefore, there was no basis for asserting that each of the timecards was a false statement submitted to the government in order to get a false claim paid. Moreover, even if we were able to demonstrate that thousands of false timecards had been presented to get the claims paid, courts have often held, over the government's objection, that they have discretion to reduce the number of forfeitures if the amount is grossly out of line with the government's actual loss. See, e.g., Peterson v. Weinberger, 508 F.2d 45 (5th Cir. 1975).

Finally, Mr. Helmer alleged that the Department threatened his client with the loss of the 10% of the recovery to which he might have been entitled as a qui tam relator if he objected to the government's "sweetheart settlement." In fact, during the course of settlement discussions, our attorney informed Mr. Helmer of our intention to settle with G.E. for $234,000 and pointed out, in connection with Mr. Helmer's objections to the settlement amount, that the government believed that it knew of Mr. Gravitt's allegations before he brought the suit, and therefore, a court could find that he was not a proper plaintiff or "relator" under the Act. Our attorney explained further that if he found it necessary to formally object to the settlement in court, we would defend the settlement on the ground, among others, that Mr. Gravitt was not a proper relator under the Act because of the government's prior knowledge, and thus Mr. Gravitt had no standing to object to the settlement. As a matter of courtesy, our attorney also informed Mr. Helmer that if that argument was accepted, Mr. Gravitt would, as a matter of law, not be entitled to a court award of up to 10% of the recovery. Because we faced some litigation risk that a court might deem the government's knowledge insufficient in light of the extent of Mr. Gravitt's disclosure statement and the fact that the government did not initially proceed with the case, we were prepared to give up our right to object to Mr. Gravitt's status as a proper relator in exchange for Mr. Gravitt foregoing any objection to the settlement with G.E.

The statements made to Mr. Helmer should be preceived in this light and not as threats in an effort to prevent public disclosure. As I noted above, we believe that we reached a good settlement, which we are prepared to defend before the District Court.

I trust that this answers any questions which might have arisen about the Department's handling of this case. If necessary, we would be prepared to provide a more detailed briefing for members of the Subcommittee or staff. While we do not ordinarily like to discuss pending litigation in such detail, I felt that it was essential to set the record straight in this matter.

Sincerely,

Richard K. Willard
RICHARD K. WILLARD
Assistant Attorney General

Mr. GLICKMAN. Our next witness is Mr. Marshall J. Breger, chairman of the legislative liaison committee of the Administrative Conference of the United States. We apologize to you for the delays, but we are glad to have you. You might introduce for the record the people who are accompanying you as well.

TESTIMONY OF MARSHALL J. BREGER, CHAIRMAN, ADMINISTRATIVE CONFERENCE OF THE UNITED STATES, ACCOMPANIED BY RICHARD K. BERG, GENERAL COUNSEL, AND JEFFREY S. LUBBERS, RESEARCH DIRECTOR

Mr. BREGER. Certainly, Mr. Chairman. I am delighted to be here and to introduce my general counsel, Richard K. Berg, and my research director, Jeffrey Lubbers. We are grateful for the opportunity to testify on H.R. 3335, the proposed Program Fraud Civil Penalties Act of 1985.

Our interest is in H.R. 3335 in a more esoteric but perhaps a no less important matter than those raised thus far today, the administrative procedures used in the act's enforcement provision. In discussing these procedural issues, however, I would like to make a number of preliminary comments and disclaimers.

First, the committee is doubtless aware the bill covers a broad variety of programs and activities. It would reach not only very large enterprises but also very small ones and, indeed, even encompass individuals who are asserting claims or seeking benefits from the Government. We are not prepared to advise the committee on the optimum scope of coverage. Practical considerations, however, both in terms of the seriousness of the violation and the financial situation of the respondent, will undoubtedly limit resort to the penalty process, notwithstanding the breadth of coverage. Nevertheless, the committee should certainly give consideration as to whether the coverage of the bill should be narrowed.

Second, we understand that there has been some question as to the standard of liability to impose, whether it should be only for intentional misstatements of fact or for some broader standard. We do not claim expertise in this area of the law and take no position on what standard of scienter should be applied; but, obviously, the standard you select depends to some extent on the situations you intend to cover. One can reasonably hold large, sophisticated enterprises to a higher standard of candor in dealings with the government than perhaps an individual applicant for unemployment benefits. I offer these simply as preliminary observations.

I would like to turn to aspects of the bill about which we do claim some expertise—administrative procedures. I want to make some recommendations about civil money penalty procedures based on recommendations that the Administrative Conference adopted in 1972 and in 1979, and these recommendations are attached to our written testimony which I hope will be included in the record of today's hearing.

Mr. GLICKMAN. Without objection.

Mr. BREGER. First of all, it is black letter law that before any civil money penalty can be collected the alleged violator must have an opportunity for some kind of hearing on the record to defend himself and to cross-examine his accusers. There are two places such a hearing may be held: in a Federal court as a trial de novo or in an agency adjudication prior to the imposition of any penalty. The traditional statutory model requires the enforcing agency to make a preliminary finding that there has been a violation and then to forward the case to the Justice Department for prosecution in a Federal district court—a trial de novo.

There are still many statutes on the books that operate in that manner. Our studies, however, have shown that this model often does not work very well for a number of reasons: (1) district court litigation is expensive; (2) U.S. attorneys often assign a low priority to these occasional cases and often settle them, we feel, too readily; (3) U.S. attorneys and Federal judges are often unfamiliar with the subject matters involved; and (4) as a result of the above the enforcement agency loses control of its own agenda and of its own priorities.

Therefore, in our recommendations we ha ve urged that Congress consider giving agencies specific authority to impose civil penalties after an agency hearing with judicial review under the substantial evidence that on the record of the agency proceeding. We recommend that the full hearing provisions of the Administrative Procedure Act, the APA, be employed in these cases, and normally that includes an initial decision by an administrative law judge

We have been very pleased with the way this recommendation has been received. The Supreme Court in 1977 in the *Atlas Roofing* case ruled that the OSHA administrative imposition model employed in the Occupational Safety and Health Act was constitutional; and since our 1972 recommendation, many major regulatory statutes use that model, including those governing mine safety, strip mining, toxic substances, fishery management, migrant worker protection, banking regulations and, of course, the Medicare fraud legislation of 1981, a direct precursor to H.R. 3335, also follows this model.

So we think that in H.R. 3335 you have wisely chosen the option of providing the constitutionally-required hearing in the agency, not in the district court, and we applaud that. Our concern, however, is that the bill, as presently drafted, deviates from APA hearing procedures and raises unnecessary questions as to the objectivity and independence of the hearing officer.

I have to become technical at this juncture so please excuse me. Section 801(8) of the bill provides that agency hearings are to be presided over by a hearing examiner, defined as and I quote, "an administrative law judge or another official designated by the authority agency." That definition goes on to provide that the hearing examiner must either be at grade GS-15 and above or, if in the military, in grade O-7 or above and be independent of the other agency officers involved in the case.

We realize that some of the agencies and departments meeting the bill's definition of on "authority" do not have enough ALJ's to hold the additional hearings that will be required under this bill. We believe that agencies should either hire new ALJ's, as HHS did in beginning its Medicare Fraud Program, or borrow them, which is specifically permitted by the APA and is often done between agencies. That is not something new or strange. In addition, a 1984 law allows agencies to reappoint retired ALJ's for a specific period or for specified cases. So the lack of ALJ's in a particular agency when this bill becomes law should not preclude the use of ALJ's.

Further, if a particular agency or department can adequately explain why it does not wish to use ALJ's in its hearing process, then the bill could specifically provide for this by designating other employees to hold hearings in that case and for that agency. Indeed, the APA contemplates such a situation in section 556(b). But in view of the penalties involved and the concerns of many expressed about this matter, we believe it would be better to amend the bill to require ALJ hearings as a general rule. As the bill now stands, there is no guarantee that "another official designated by the authority head," to quote the language of the bill, will be independent enough to satisfy the need for an adjudicative process which is fair and is perceived to be fair.

As an aside, Mr. Chairman, I know you and others have been interested in proposals to make ALJ's completely independent of enforcement agencies by separating them into a central ALJ corps. This is, of course, a subject for another day, but I would point out that by permitting agencies to use officials who lack even the independence that ALJ's currently have, this bill goes in the opposite direction.

Moreover, the dichotomy between the ALJ hearings and the non-ALJ hearings contemplated by the bill introduces unnecessary confusion into those provisions which deal with hearing procedures; and we submit that this confusion, this mish-mash, is unnecessary. The APA already provides a tried and true set of procedures that courts have validated as meeting due process requirements.

In sum, we believe the bill's starting point should be to require the civil penalty proceedings to follow the adjudication procedures of the Administrative Procedure Act in all cases, and that includes use of ALJ's as presiding officers, except where justification is shown for deviation. That is to say, the APA allows for service as presiding officers by "employees specially provided for by or designated under statute," 5 USC 556(b). There is no reason to have this bill give the agencies a blank check to depart from the APA model. To obtain the benefits of agency imposition of civil money penalties the agency adjudications must be fair and must be perceived to be fair. The APA, we suggest, provides the ready-made solution.

If I might speak for a moment as a citizen and not as the chairman of a Federal agency, I support fully the substantive goals of this bill. Every dollar saved or recouped by cracking down on fraud will mean one more dollar that is saved taxpayers. The Administrative Conference stands ready to assist the committee and your staff in making any modifications to the bill that will accommodate our procedural concerns. I should warn you that we, indeed, have some specific minor drafting points which we would be happy to share with your staff.

Thank you for affording us an opportunity to present our views today, and we sincerely hope that the Program Fraud Civil Penalties Act will soon become a public law.

[The statement of Marshall J. Breger follows:]

(REVISED)

HEARING BEFORE THE

SUBCOMMITTEE ON ADMINISTRATIVE LAW AND GOVERNMENTAL RELATIONS

OF THE HOUSE JUDICIARY COMMITTEE

ON

H.R. 3335

THE PROGRAM FRAUD CIVIL PENALTIES ACT OF 1985

TESTIMONY OF
MARSHALL J. BREGER, CHAIRMAN

ADMINISTRATIVE CONFERENCE OF THE UNITED STATES

Accompanied by:

Richard K. Berg
General Counsel

Jeffrey S. Lubbers
Research Director

February 6, 1986

Mr. Chairman and Members of the Committee

I am Marshall J. Breger, Chairman of the Administrative Conference of the United States. With me today are Richard K. Berg, my General Counsel and Jeffrey S. Lubbers, my Research Director.

I am grateful for the opportunity to testify on H.R. 3335, the proposed Program Fraud Civil Penalties Act of 1985. This important bill would provide an administrative procedure for imposing civil penalties for false claims and statements made to the United States in connection with agency programs. It would cover a broad range of agencies and programs and be administered by the respective agencies affected by such frauds. We are interested in this legislation, not only because it is an integral part of the President's Anti-Fraud Enforcement Initiative, but also because of the Administrative Conference's long-standing support for the use of civil money penalties as an enforcement technique. We have also been a leading proponent of administrative agency imposition of civil money penalties based on our belief that administrative agencies, through the use of formal hearings held under the Administrative Procedure Act, can ordinarily provide a fair hearing faster, more efficiently, and more inexpensively than the equivalent trial by a federal district court.

For these reasons, we applaud the Committee's consideration of this bill and approve of the bill's general approach, but we would like to make a number of preliminary comments and disclaimers. First, as the Committee is doubtless aware, the bill covers a broad variety of programs and activities. It would reach very large enterprises, but also very small ones, and, indeed, even individuals asserting claims or seeking benefits from the Government. We are not prepared to advise the Committee on the optimum scope of coverage. Practical considerations, both in terms of the seriousness of the violation and the financial situation of the respondent, will undoubtedly limit resort to the penalty process, notwithstanding the breadth of coverage. Nevertheless, the Committee will certainly give consideration to whether the coverage of the bill should be narrowed. Second, we understand there has been some question as to the standard of liability to impose—whether it should be only for intentional misstatements of fact or some broader standard. We are not familiar with this area of the law and take no position on what standard of scienter should be applied, but obviously the standard you select depends to some extent on the situations you intend to cover. One can reasonably hold large sophisticated enterprises to a higher standard of candor in dealings with the Government than, perhaps, an individual applicant for unemployment benefits. I offer these simply as preliminary observations.

As you know, Mr. Chairman, the Administrative Conference of the United States is a federal agency whose mission is to study problems and recommend improvements in the administrative procedures used by federal departments and agencies. The Conference's unique structure, with its membership of designated representatives of federal agencies and volunteer public members who include distinguished private practitioners and law professors, enables it to bring a valuable perspective to procedural matters.

We have addressed civil money penalty procedures twice. Beginning in 1972 (See Recommendation 72-6, attached), we have supported the use of civil penalties based on their several advantages. Unlike criminal sanctions, license revocations or debarments, they can be used against less serious offenses, and are feasible where the offender provides services which cannot be disrupted without public harm. Moreover, civil penalties do not stigmatize as much as criminal penalties, and are therefore less likely to discourage prosecutorial decisions. Finally, unlike most courts imposing fines, agencies assessing penalties can develop expertise and relatively precise formulas and can also use informal processes for assessing and mitigating penalties without the need for a hearing.

Civil money penalty statutes are no longer rare; even without this bill, there are already over 350 statutory civil penalty provisions, enforced by dozens of agencies. However, under most of these statutes, the penalty cannot be imposed until the agency (normally through a U.S. Attorney) has succeeded in a de novo adjudication in federal district court. Our study found that this scheme often did not work well because of the expense of district court litigation, the tendency of U.S. Attorneys to assign a relatively low priority to these occasional regulatory cases and to often settle them too readily, the unfamiliarity of U.S. Attorneys and judges with the subject matters involved, inconsistent results in the many district courts, and the inability of the enforcement agency to control its own agenda.

In part B of our 1972 recommendation, we therefore urged agencies and Congress to consider the desirability of administrative imposition of civil penalties after an agency hearing, and concluded that such a scheme is preferable to court adjudication where there is a large volume of cases, where speedy adjudication is important, where issues of law (e.g. statutory interpretation) requiring judicial resolution are rare, where consistency of outcome and size of penalties imposed is important, and where the penalties are likely to be relatively small.

At the time the recommendation was adopted, few statutes provided for administrative, as opposed to judicial, imposition of civil penalties. However, in recent years, in response perhaps to our urgings, and, certainly to the increasingly urgent need to alleviate the burden on the federal courts, Congress has frequently provided for administrative imposition under procedures similar to those set forth in H.R. 3335. One example, of course, that is closely analogous to the Program Fraud bill is the medicare fraud civil penalty program administered by the Department of Health and Human Services under the Medicare and Medicaid Amendments of 1981, 42 U.S.C. §1320a-7a.* Moreover, in 1977, constitutional questions raised by administrative imposition of civil money penalties were largely put to rest by the Supreme Court in Atlas Roofing Co. v. OSHRC, 420 U.S. 442 (1977). Finally, in 1979, the Administrative Conference in Recommendation 79-3 (attached), reaffirmed its support of administrative imposition and welcomed the increased use of such procedures since our 1972 recommendation.

Given this history, it should be no surprise that we strongly support the principal thrust of H.R. 3335 and its general approach of assigning the adjudication of civil penalties for program fraud to the administering agencies. However, we also believe that for such a system to work, the fairness of the administrative proceeding and the impartiality of the forum must be unquestioned. It is in this area where we believe the bill needs some modification.

Under our own recommendations and in the administrative imposition statutes discussed earlier (including the OSHA program at issue in the Atlas Roofing case), the agency is required to offer the alleged violator notice and opportunity for a hearing on the record pursuant to the Administrative Procedure Act, 5 U.S.C. §554-57. This ordinarily means that the hearing is conducted by an administrative law judge (ALJ), appointed under 5 U.S.C. §3105, whose tenure and decisional independence is protected by other provisions in title 5. After the hearing and initial decision, the violator may, of course, seek review by the agency head and then judicial review in the court of appeals under the APA's substantial evidence test, 5 U.S.C. §706(2)(E).

---

* Other important recent regulatory statutes prescribing this model include laws governing: worker safety (OSHA), 29 U.S.C. §§659, 666; mine safety, 30 U.S.C. §815; strip mining, 30 U.S.C. §1268; toxic substances, 15 U.S.C. §2615, fishery management, 16 U.S.C. §1858; migrant worker protections, 29 U.S.C. §1853; commodities trading, 7 U.S.C. §9; communications regulation, 47 U.S.C. §503(b); banking regulation, 12 U.S.C. (various provisions), and agricultural violations, 7 U.S.C. (various provisions).

In this regard, it would be appropriate to remind ourselves that when the Administrative Procedure Act was being debated in the early 1940's, one of the key issues was the independence of the presiding agency hearing officers. Prior to the APA there were no reliable safeguards to ensure the objectivity and judicial capability of presiding officers in formal administrative proceedings. Ordinarily these officers were subordinate employees chosen by the agencies, and the power of the agencies to control and influence such personnel made questionable the contention of any agency that its proceedings assured fundamental fairness. The APA was designed to correct these conditions, and we have now reached the point where the Supreme Court can confidently say:

> "There can be little doubt that the role of the modern federal hearing examiner or administrative law judge is 'functionally comparable' to that of a judge. . . . More importantly, the process of agency adjudication is currently structured so as to assure that the hearing examiner exercises his independent judgment on the evidence, free from pressures by the parties or other officials of the agency."
>
> Butz v. Economou, 438 U.S. 478, 513 (1978)

In view of this settled consensus on the role of the administrative law judge, and the need for decisional independence, we question the wisdom of H.R. 3335's partial deviation from the APA hearing procedures. The bill [see §801(8)] provides that agency hearings are to be conducted by a "hearing examiner" (a better alternative term would be "presiding officer"), defined as "an administrative law judge or another official designated by the authority head. . . ." (emphasis added). The definition goes on to provide that the hearing examiner must either be at grade GS-15 and above or, if in the military, in grade 0-7 or above, and be independent of the other agency offices involved in the case. We realize that some of the agencies and departments meeting the bill's definition of "authority" do not have enough ALJs to hold the additional hearings to be required under this bill. This is not a reason to exempt them from the APA's hearing provisions. We believe that agencies should either hire new ALJs (as HHS did in beginning its medicare fraud program) or borrow them under the terms of 5 U.S.C. §3344. In addition, under Public Law 98-224 (1984), agencies may reappoint retired ALJs for a specified period or for specified cases, 5 U.S.C. §3323(b)(2).

If a particular agency or department can adequately explain why it does not wish to use ALJs for these hearings, then the bill could provide for this by specifically designating other employees to hold the hearing. Such designations are contemplated by the APA, §556(b), and have been occasionally used, as in the Atomic Energy Act, which permits hearings before Atomic Safety Licensing Boards. However, in view of the size of the penalties involved and the concerns of the bar associations already expressed about this bill, we question whether any deviation from the APA pattern is desirable. As the bill now stands there is no guarantee that "another official designated by the authority head" will be independent enough to satisfy the need for an adjudicative process which is fair and is perceived to be fair.

Furthermore, the bill introduces unnecessary confusion by distinguishing in its procedural requirements between the ALJ hearings and the "non-ALJ" hearings. In section 803(f)(1), the bill provides that if the hearing is conducted by an ALJ, the procedures should follow the APA, but that otherwise the hearing is to follow either the APA or procedures promulgated by the authority head which must include a set of provisions enumerated in §803(f)(2), most, but not all of which, track the APA. We submit that this confusion and complication is unnecessary when the APA already provides a tried-and-true, set of procedures that courts have validated as meeting due process requirements. In this connection, let me quote from one of my esteemed predecessors, now-Judge Antonin Scalia, who in a 1974 letter to Chairman Dingell on another bill, made the following complaint, which unfortunately too often remains valid twelve years later:

> " In recent years, there has been a visible and steady erosion of standardized administrative practice, through individualized provisions contained in new pieces of regulatory legislation where no real reason for individualized treatment exists. While absolute standardization, of course, is not desirable, the basic principle of a uniform administrative practice, with only such variations as operational differences justify, serves several important values. It is indispensible to the retention of an administrative system that can be fathomed by the general public and penetrated by lawyers who are not specialists in narrow fields of Federal practice. It is helpful to the courts in their review of agency action, facilitating the development of overall principles of judicial review and enabling the creation of a body of case law that can serve as precedent in more than one limited field. Finally, and perhaps most important, an allegiance to a standard body of procedural principles such as that contained within the APA has great advantages in the legislative process. The procedural provisions of major substantive legislation are understandably not the portions to which the Congress devotes its closest attention; and the comments it receives from both the agencies and the private sector are inclined to dwell upon the extent, rather than the manner, of the regulation that is to be imposed. It is generally desirable, then, for the Congress to adhere to the judgments it made when procedure itself was the center of its attention rather than merely the incidental accompaniment of a substantive program under examination. Those judgments are likely to be significantly more sound than the random procedural innovations which may slip by with each new piece of substantive legislation.
>
> "[Letter from Antonin Scalia, Chairman of the Administrative Conference, to Hon. John D. Dingell, on H.R. 7917, May 23, 1974, at page 4.]

In sum, we believe the bill's starting point should be to require the civil penalty proceedings to follow the adjudication procedures of the Administrative Procedure Act, unless some agency can establish a need for special treatment in all cases. This includes use of ALJs as presiding officers. To obtain the benefits of agency imposition of civil money penalties, the agency adjudications must be fair and perceived to be fair. The

APA provides the ready-made solution.

As a citizen, not an expert, Mr. Chairman, I support the aims of the substantive provisions of this bill. We of course, stand ready to assist the Committee and your staff in making any modifications to the bill that will accomodate our procedural concerns. We also have some other more minor drafting points which we will be glad to share with your staff.

We appreciate the chance to participate today, and we sincerely hope the Program Fraud Civil Penalty Act will soon become a public law.

§ 305.72-6 Civil Money Penalties as a Sanction (Recommendation No. 72-6).

(a) Federal administrative agencies enforce many statutory provisions and administrative regulations for violation of which fixed or variable civil money penalties may be imposed.[1] During Fiscal 1971, seven executive departments and thirteen independent agencies collected well in excess of $10 million, in over 15,000 cases, all evidence points to a doubling or tripling dollar magnitude and substantially increasing caseload within the next few years.

(b) Increased use of civil money penalties is an important and salutary trend. When civil money penalties are not available, agency administrators often voice frustration at having to render harsh "all-or-nothing decisions" (e.g., in license revocation proceedings), sometimes adversely affecting innocent third parties, in cases in which enforcement purposes could better be served by a more precise measurement of culpability and a more flexible response. In many areas of increased concern (e.g., health and safety, the environment, consumer protection) availability of civil money penalties might significantly enhance an agency's ability to achieve its statutory goals.

(c) In developing a range of sanctions adequate to meet enforcement needs, Congress and agencies must often determine whether a "criminal fine" or a "civil money penalty," or both, should be applied to a given regulatory offense. The choice they make has large consequences. Criminal penalties expose an offender to the disgrace and disabilities associated with "convictions"; they require special procedural and other protections; and they can not be imposed administratively. These factors make it appropriate to consider whether criminal sanctions should not be supplemented or replaced by civil money penalties.

(d) Under most money penalty statutes, the penalty cannot be imposed until the agency has succeeded in a de novo adjudication in federal district court, whether or not an administrative proceeding has been held previously. The already critical overburdening of the courts argues against flooding them with controversies of this type, which generally have small precedential significance.

(e) Because of such factors as considerations of equity, mitigating circumstances, and the substantial time, effort and expertise such litigation often requires in cases usually involving relatively small sums (an average of less than $1,000 per case), agencies settle well over 90 percent of their cases by means of compromise, remission, or mitigation. Settlements are not wrong *per se*, but the quality of the settlements under the present system is a matter of concern. Regulatory needs are sometimes sacrificed for what is collectible. On the other hand, those accused sometimes charge that they are being denied procedural protections and an impartial forum and that they are often forced to acquiesce in unfair settlements because of the lack of a prompt and economical procedure for judicial resolution. Moreover, several agency administrators warn that some of the worst offenders, who will not settle and cannot feasibly be brought to trial, are escaping penalties altogether.

This recommendation is intended to meet the problems posed above.

RECOMMENDATION

A. *Desirability of Civil Money Penalties as a Sanction.* 1. Federal administrative agencies should evaluate the benefits which may be derived from the use (or increased use) of civil money penalties as a sanction. Such penalties should not be adopted as a means of supplanting or curtailing other private or public civil remedies.

2. Civil money penalties are often particularly valuable, and generally should be sought, to supplement those more potent sanctions already available to an agency—such as license suspension or revocation—whose use may prove: (a) Unduly harsh for relatively minor offenses, or (b) infeasible because, for example, the offender provides services which cannot be disrupted without serious harm to the public.

3. Each federal agency which administers laws that provide for criminal sanctions should review its experience with such sanctions to determine whether authorizing civil money penalties as another or substitute sanction would be in the public interest. Such authority for civil money penalties would be particularly appropriate, and generally should be sought, where offending behavior is not of a type readily recognizable as likely to warrant imprisonment.

B. *Adjudication of Civil Money Penalty Cases in an Administrative Imposition System.* 1. In some circumstances it is desirable to commit the imposition of civil money penalties to agencies themselves, without subjecting agency determinations to *de novo* judicial review. Agencies should consider asking Congress to grant them such authority.[2]

Factors whose presence tends to commend such a course with respect to a particular penalty provision include the following:

(a) A large volume of cases likely to be processed annually;

(b) The availability to the agency of more potent sanctions with the resulting likelihood that civil money penalties will be used to moderate an otherwise too harsh response;

(c) The importance to the enforcement scheme of speedy adjudications;

(d) The need for specialized knowledge and agency expertise in the resolution of disputed issues;

(e) The relative rarity of issues of law (*e.g.*, statutory interpretation) which require judicial resolution;

(f) The importance of greater consistency of outcome (particularly as to the penalties imposed) which could result from agency, as opposed to district court, adjudications; and

(g) The likelihood that an agency (or a group of agencies in combination) will establish an impartial forum in which cases can be efficiently and fairly decided.

Considerations such as those set forth above should be weighed heavily in favor of administrative imposition when the usual monetary penalty for an offense or a related series of offenses would be relatively small, and should normally be decisive when the penalty would be unlikely to exceed $5,000. However, the benefits to be derived from civil money penalties, and

---

[1] For purposes of this recommendation, no distinction has been drawn between sanctions denominated "money penalties" and sanctions denominated "forfeitures" (e.g., in FCC legislation) and "fines" (e.g., in Postal Service legislation) so long as: (i) The sanction is classified as civil and (ii) money is, in fact, subject to collection by an agency or a court. Excluded are situations involving penalties or liquidated damages assessed pursuant to the terms of a government contract or sums withheld or recovered for failure to comply with the terms of a government grant.

[2] Due to the special procedures and status of the United States Tax Court, the rationale for administrative imposition may have only limited applicability to civil money penalties administered by the Internal Revenue Service.

§ 305.79-3 Agency Assessment and Mitigation of Civil Money Penalties (Recommendation No. 79-3).

(a) The civil money penalty has become one of the most widely used techniques in the enforcement programs of federal administrative agencies. Most regulatory offenses punishable by civil penalties involve adverse social consequences of private business activity. The motivational impact of these penalties depends in large part on the certainty of imposition and uniformity of amount, although some cases may require individualized tailoring to the circumstance of the offender so as to remove the economic benefit of the illegal conduct. Other civil penalties may also serve a secondary function of compensating society for the harm caused by unlawful conduct.

(b) Recommendation 72-6 urged that the advantages of civil money penalties would be best achieved through an "administrative imposition system" in which the agency would be empowered to adjudicate the violation and impose the penalty after a trial-type hearing, subject to "substantial evidence" judicial review. Such a system, it was stated, would avoid the delays, high costs, and jurisdictional fictions inherent in the traditional and most common system of imposing civil money penalties by a court in a civil action initiated on behalf of the agency by the Department of Justice.

(c) Since adoption of that Recommendation in 1972, the use of civil money penalties in general and of administratively imposed civil money penalties in particular has increased significantly, and the constitutionality and desirability of administratively imposed penalties has been widely recognized.

(d) Experience has shown that agencies play a crucial role and exercise broad discretion in the administration of civil penalty programs, whether or not the statute in question authorizes an administrative imposition system. Agencies possessing such authority have found it efficient to try to resolve cases before the formal hearing stage, through settlement and negotiation. Those agencies not possessing administrative imposition authority operate under a wide variety of statutes: some make no express reference to an agency role in the penalty process, while others confer on the agency only a power to "assess" or to "mitigate" penalties, thereby expressly or implicitly reserving to the respondent the right to seek a subsequent de novo fact-finding hearing by the court in a collection proceeding. Agencies typically exercise their statutory authority to "mitigate" in resolving contested penalty assessments prior to the initiation of formal enforcement action. In these recommendations the term "mitigation" refers to any informal process of resolving a contested initial penalty assessment.

(e) Whatever the statutory framework, the enforcing agency typically makes the initial assessment, and provides a process for mitigation of the penalty. Thus, both where there exists administrative imposition authority and where such authority does not exist, agencies and respondents customarily utilize these initial assessment and mitigation processes to resolve the great majority of civil money penalty cases without reaching the stage of formal administrative adjudication or court collection proceeding.

(f) These informal processes for the initiation and termination of civil penalty proceedings represent an area of previously unstudied and largely discretionary agency action. Appropriate standards and structures for the exercise of such discretion are needed to improve the consistency, efficiency and openness of agency assessment and mitigation processes.

(g) The recommendations that follow focus on: (1) The need for agencies to develop standards for determining penalty amounts, (2) agency procedures for initially assessing penalties, (3) agency mitigation procedures, and (4) the use by agencies of evidentiary hearings to impose civil penalties where such a procedure, though not required by statute, might result in a limited scope of judicial review.

RECOMMENDATION

A. STANDARDS FOR DETERMINATION OF PENALTY AMOUNT

1. Agencies enforcing regulatory statutes, violation of which is punishable by a civil money penalty, should establish standards for determining appropriate penalty amounts for individual cases. In establishing standards, agencies should specify the factors to be considered in determining the appropriate penalty amount in a particular case. To the extent practicable, agencies should specify the relative weights to be attached to individual factors in the penalty calculation, and incorporate such factors into formulas for determining penalty amounts or into fixed schedules of prima facie penalty amounts for the most common types or categories of violation. A penalty intended to deter or influence economic behavior should, at a minimum, be designed to remove the economic benefit of the illegal activity, taking into account the documented benefit and the likelihood of escaping detection. Penalty standards should, in ad-

BEST COPY

gation, specify whether and to what extent the agency will consider other factors such as compensation for harm caused by the violation or the impact of the penalty on the violator's financial condition. In order to reduce the cost of the penalty calculation process and increase the predictability of the sanction, simplifying assumptions about the benefit realized from or the harm caused by illegal activity should be utilized.

2. Agencies should periodically evaluate the continuing effectiveness of their penalty standards. Such evaluations should be based upon the results of compliance surveys and internal audits of agency assessment and mitigation decisions as well as data on the nature and frequency of violations routinely generated by the agency's enforcement program.

3. Agencies should make such standards known to the public to the greatest extent feasible through rulemaking or publication of policy statements. Such an approach is especially desirable where adjudications that produce written decisions are rare.

4. Agencies should collect and index those written decisions made in response to mitigation requests or after agency assessment hearings, and make such decisions available to the public except to the extent that their disclosure is prohibited by law. Whenever a respondent cites a previous written decision as a precedent for the agency to follow in the respondent's case, the agency should either do so, distinguish the two cases, or explain its reasons for not following the prior decision.

B. INITIAL ASSESSMENT OF PENALTIES

1. Agencies should give adequate written notice to the respondent of the factual and legal basis for, and amount of, the penalty assessment.

2. Agencies should not mechanically assess variable civil money penalties at the statutory maximum if reliable evidence in their possession indicates the presence of mitigating factors. Nor, if they possess such evidence, should agencies assess at the statutory level fixed penalties which are subject to an express administrative "mitigation" authority.

3. The greater the degree to which an agency decentralizes its penalty assessment authority, the more it should structure the exercise of that authority by the use of highly specific standards. Agencies should not ordinarily delegate discretionary authority to assess civil money penalties to investigative personnel unless the delay inherent in review by an independent assessment official would materially impair the effectiveness of the enforcement process.

C. MITIGATION OF PENALTIES

Respondents in civil money penalty cases have a right to a trial-type hearing at either the administrative or judicial level. It is nevertheless desirable that agencies establish fair and economical procedures whereby respondents may informally contest the initial assessment of civil penalties without the necessity of going forward to trial-type hearings. These procedures should be governed by the following principles:

1. Agencies should provide the respondent with a right to reply in writing to a penalty claim.

2. Agency staff should not refuse a reasonable request to discuss a penalty claim orally. But an informal conference need not be built into the process except in those categories of cases where the use of written communications is likely to prove inadequate because of such factors as the unsophistication of violators or the prevalence of factual disputes.

3. Agencies should consider providing an opportunity for administrative review of a decision denying a request for mitigation.

4. Agency decisions on mitigation requests should be in writing and should be accompanied by a brief indication of the grounds for the decision.

5. In regulatory programs typically involving the imposition of small penalties, agencies may appropriately rely most heavily on readily ascertainable standards of liability, fixed schedules of prima facie penalty amounts for the most common types of categories of violations, and highly objective inspection procedures. Opportunity for mitigation should be narrowly confined and mitigation requests entertained only if in written form.

6. In regulatory programs typically involving the imposition of large penalties, agencies may appropriately provide an opportunity to a respondent to present a request for mitigation, orally or in writing, request an oral conference thereon, receive a written decision, and submit a written petition for review of such decision or for compromise of such claim at a higher agency level.

D. EVIDENTIARY HEARINGS

As expressed in Recommendation 72-6, it is desirable that agencies be given express authority to employ the procedures of adjudication on the record pursuant to the APA, 5 U.S.C. 554-557, for the imposition of civil money penalties. Where its statute does not provide for such procedure but confers upon the agency authority to "assess" or to "mitigate" a penalty, particularly if the agency is required to conduct a "hearing," the agency should consider establishing such procedures by regulation, especially where by doing so a de novo proceeding upon judicial review could be avoided. Where such a hearing procedure has in fact been observed by the agency, and the statute does not provide for de novo judicial proceedings, the court should ordinarily utilize a limited scope of review of such agency action imposing civil money penalties.

[44 FR 38826, July 3, 1979]

the administrative imposition thereof, should also be considered when the penalties may be relatively large.

2. An administrative imposition system should provide:

(a) For and adjudication on the record pursuant to the Administrative Procedure Act, 5 U.S.C. 554-57 (1970), at the option of the alleged offender or the agency;

(b) For finality of an agency's decision unless appealed within a specified period of time;

(c) That, if the person on whom the penalty is imposed appeals, an agency's decision will be reviewed in United States Courts of Appeals under the substantial evidence rule in accordance with the Administrative Procedure Act, 5 U.S.C. 706(e);

(d) That issues made final by reason of (b) above and issues which were raised, or might have been raised, in a proceeding for review under (c) above may not be raised as a defense to a suit by the United States for collection of the penalty.

Agencies should adopt rules of practice which will enable just, inexpensive and speedy determinations. They should provide procedures for settlement by means of remission, mitigation or compromise.

Mr. **Glickman**. Thank very much, Mr. Breger.

I want to ask you a question that relates to the applicability of this law to the Defense Department and how the APA is brought into it. I was about ready to introduce a bill yesterday which incorporated not only some of the provisions that we have talked about before, increasing civil penalties, but also program fraud provisions. It suddenly hit me that the Defense Department having hearing examiners to hear cases and render penalties against civilian contractors might present some very serious statutory and perhaps constitutional problems in that the Defense Department, I believe, takes the position that they are not subject to the Administrative Procedures Act in many of their dealings. It concerned me that we could have a serious due process problem if we passed a bill giving perhaps a military tribunal authority to impose fines, civil penalties on civilian contractors. That was a whole different ballgame under debarment or suspension. I wonder if you might comment to that.

Mr. **Breger**. I would be happy to do so. Let me first say that you are correct, Mr. Chairman, or rather the Defense Department is correct in saying that the Administrative Procedure Act has exceptions from certain requirements for military and foreign affairs activities. However, we believe that the case law will show that these exceptions do not go by agency but rather by function; that is to say, military function or foreign affairs function. It would be, of course, a question of specific statutory interpretation whether matters of procurement fraud which you are attempting to consider here, would fall into that military—function—exception.

As to the more general question, whether civil penalities can be given by military personnel, I am going to ask my general counsel here, Mr. Berg, to address that more specifically; but the point of having ALJ's as opposed to the present situation in H.R. 3335 which, in fact, military officers who are over O-7 in grade, to make those decisions is to ensure the kind of autonomy and independence you are talking about, and I believe that ALJ civilian employees of the DOD would be able to do that.

Mr. **Berg**. Well, I hesitate to state the conclusion very firmly. I do not think there would be any constitutional problem if the bill made it clear that that was what was contemplated, but it would certainly be an unusual result. I cannot think of any analog in our present practice. I believe military officers do deal with debarment and, as a practical matter, debarment can be more painful, more costly than civil penalties, but still the law has traditionally recognized a distinction between those two kinds of procedures.

Mr. **Glickman**. But clearly designating those people within the Defense Department who would hear these cases as ALJ's and using ALJ's as defined under the law would at least negate a lot of the problem you see in terms of having an other designees, people who are in the right GS classification, but who knows what they do for a living, handle these cases. You see, we are talking about 80 percent of procurement in government is Defense Department related, so it is more than an academic problem. This is the heart of the civil program section, and in my mind raises the question as to what the Pentagon would do to implement this bill or what the Defense Department would do with such provisions. I think that your suggestions are very good ones and I think that we should try to draft this in such a way that it brings the APA in as much as possible. Otherwise, I fear that we are going to have serious challenges by everybody who is going to be hit by one of these penalties, a claim that due process has been violated, and they may be right as far as I know.

Let me ask you this, going back to the ALJ issue. Do you think it is necessary to designate an employee as the equivalent of an ALJ even if the agency explains why it does not want to use ALJ's? For example, NASA does not have ALJ's, I do not think.

Mr. LUBBERS. That is correct, Mr. Chairman. There are about 28 agencies in the Government that do employ their own administrative law judges. Other agencies, as Chairman Breger pointed out, borrow them regularly from other agencies, and there is no reason why NASA or the Department of Defense could not receive authority from the Office of Personnel Management to hire some ALJ's. But if you wanted to set up a scheme where the Department of Defense did use officers that were equivalent to administrative law judges, you could do that as the APA permits.

Another alternative might be to use the Armed Services Board of Contract Appeals which already has judges who are for all practical purposes equivalent to administrative law judges in their independence and so forth. But I think——

Mr. GLICKMAN. Are they all civilian?

Mr. LUBBERS. I do not know.

Mr. GLICKMAN. Does that matter?

Mr. LUBBERS. I do not think it should matter on a constitutional level whether or not they are civilians. However, it might be hard to provide military officers the same protection of tenure as the APA provides for ALJ's. The way somebody becomes an administrative law judge, is he or she has to pass an examination, administered by OPM and it is a fairly rigorous merit selection process.

Mr. GLICKMAN. OK. I think that the suggestions you make in your statement, Mr. Breger, are ones we are going to try to incorporate in the bill I introduce. I am going to withhold the introduction of the bill until such time I can clarify the provisions because these are the ones that are causing me some concern.

Mr. BREGER. Mr. Chairman, we would be happy to work with you and your staff in any way you think would help make a better product in this area.

Mr. GLICKMAN. You see, I think to some extent, you know, I am going to draft a bill to prevent program fraud wherever it exists, but we do have some basic need to adhere to due process principles in this Government. So I want to make sure that we can conform this to what the case law and statutes have said we have to do; otherwise, I think the fears of some contractors that they can be subject to Star Chamber procedures could be well founded.

Mr. BREGER. I might just add, Mr. Chairman, that a bill which tracks the Administrative Procedure Act would still allow for full and vigorous prosecution of program fraud.

Mr. GLICKMAN. OK. Thank you for your testimony.

Mr. BREGER. Thank you.

Mr. GLICKMAN. The last witness, and I hate to do this to you, but we have two bells and we will be back in 15 minutes and we will try to finish it up fairly quickly. The alternative is for you to try to do it in 5 minutes, the American Bar Association, or about 3½ minutes, and I do not want to do that to you

[Recess.]

Mr. GLICKMAN. The last witness, not the least——

Ms. WILLIAMS. Thank you.

Mr. GLICKMAN [continuing]. Is Karen Hastie Williams, chairman of the Legislative Liaison Committee of the Public Contract Law Section of the American Bar Association.

TESTIMONY OF KAREN HASTIE WILLIAMS, CHAIRMAN, LEGISLATIVE LIAISON COMMITTEE OF THE PUBLIC CONTRACT LAW SECTION OF THE AMERICAN BAR ASSOCIATION, ACCOMPANIED BY ALAN C. BROWN, CHAIRMAN OF THE SECTION'S PROCUREMENT FRAUD COMMITTEE

Ms. WILLIAMS. Thank you very much, Mr. Chairman. It is a pleasure to be with you this afternoon.

I have a prepared statement and I would ask that it be incorporated in its entirety into the hearing record. In light of the late hour I will try to summarize the highlights of our testimony for the benefit of the committee.

As the committee is aware, the Public Contract Law Section has taken an active role in the consideration of procurement reform legislation, both in this Congress and in previous Congresses. We were pleased to testify on S. 1134, the Program Fraud Civil Penalties Act on the Senate side, and are pleased to be here today to testify on its companion legislation as well as amendments to the False Claims Act in the House.

Our testimony before the Senate focused on several are as of concern with respect to protecting due process rights of individuals who were charged with violation of the program fraud civil penalties legislation. We would hope that the concerns we expressed there would be considered by this committee. For that reason we have appended to our testimony today comments made before the Senate Governmental Affairs Committee and a letter to Senator Cohen. The letter expresses our concern about the bill that was finally reported in four areas: (1) the standard of knowledge; (2) the continued existence of testimonial subpoena power; (3) the lack of independent prosecutorial review; and (4) the excessive and duplicative penalties. We hope those issues may yet be ironed out before that bill is finally passed the other body.

Our testimony here today, Mr. Chairman, is going to focus on the appropriate knowledge standard, an issue which is equally applicable to the program fraud bill and to the proposed amendments to the False Claims Act. I think it is fair to say that the program fraud bill is conceived as a mini-False Claims Act. Logically, the two measures should incorporate the same standard of intent. Let me summarize for you the five principles that the section feels should guide the standard of intent.

First, the proceedings contemplated by these bills are fundamentally actions for fraud. Like the existing civil False Claims Act, the legislation authorizes imposition of substantial penalties, including double damages, on persons who submit false, fraudulent, or ficticious claims. Both the nature of the charge and the severity of the penalties dictate that these proceedings should not be lightly initiated or liability unfairly assessed. Accordingly, our first principle is that it is important that whether or not a person is liable for fraud should hinge on the person's actual state of knowledge at the time of the alleged offense, and liability should require proof of culpability.

The second principle we would articulate is that we do not believe a specific intent to defraud the United States should be a necessary element of liability under these bills. We agree with the overwhelming majority of the courts that have looked at this issue and have ruled that proof of actual knowledge of a falsity is sufficient prerequisite for liability under the False Claims Act.

The third principle we would suggest is that in certain circumstances reckless conduct that evinces disregard for the truth of a statement or deliberate efforts to shield one's self from the knowledge of falsity may reflect sufficient culpability that actual knowledge can be inferred. Thus adoption of a reckless disregard for the truth standard would comport with the most liberal interpretations of the False Claims Act and would, in our view, adequately protect the United States from persons who attempt to avoid liability for their deceit by deliberate efforts to keep from learning the truth.

The fourth principle we would suggest to the committee is that efforts to adjudicate charges of fraud by comparison of a person's conduct to undefined subjective standards or duties without regard to the person's actual culpability or state of mind are inappropriate and patently unfair.

Lastly, we would hope that any legislation that this committee supports would assure that mistakes, inadvertence, negligence, and sloppiness are not fraud and are not treated as fraud in the legislation.

Mr. Chairman, the program fraud civil penalties legislation, both S. 1134 and the bills pending before this committee, should be viewed as alternative administrative remedies to the False Claims Act. It is important to remember that these pieces of legislation are intended to be remedial and they are not supposed to be penalty legislation. I think that some of the testimony that has been presented to this committee painfully suggests there are those who view this as penalty legislation and not remedial legislation.

We believe that the starting point for considering the appropriate standard of knowledge under the false claims legislation and program fraud legislation is to look at the case law that has been developed under the False Claims Act. Our written testimony goes into the law in detail, and I would commend it to the committee.

Let me say that the standard adopted by the eighth circuit and also by the Federal circuit here in the District of Columbia, which probably hears most of the Federal payment cases in the context of contract cases, tax cases and personnel cases, has adopted a constructive knowledge test and has held that recklessness or carelessness in the extreme is sufficient knowledge to give rise to liability under the False Claims Act. Other courts have moved along the spectrum in terms of the standard of intent. Those are detailed in our written testimony.

Let me just say for the record that we do believe that clarity in defining the standard of intent is most important. When we have situations in which administrative law judges in a number of different agencies are the decisionmakers for civil false claims, it is important that they have some clear guidance in terms of the applicable standard of intent.

In looking at the position that the Justice Department has taken recently, there is clearly some inconsistency with the position that they took before the Senate when it was conducting hearings on the program fraud civil penalties bill. We are very concerned that their apparent endorsement of a substantially reduced negligence standard, that is, a gross negligence standard, would ignore the individual's culpability or state of mind by inventing a subjective duty to inquire. This standard, if adopted, would significantly decrease the standard of intent necessary to impose penalties on persons for false claims or false statements. I would commend to the committee the discussion of the distinction between negligence and knowledge in a recent Massachusetts case, Computer Systems, which is detailed in our written testimony.

There is a substantial body of case law with respect to reckless disregard of the truth, and it occurs in various instances, not only in the case of contracts but mail fraud, debt and bankruptcy, challenges to search warrants, libel, and slander. Again, we think that it is important that this committee consider what the jurisprudence is in this area before going forward with some new, untested standard.

At least seven different standards by our count have been proposed by members for the program fraud civil penalties bill. They can generally be grouped into two categories. One category would impose a duty to inquire on persons submitting statements or claims to the United States. This duty of inquiry, we believe, would impose substantial liability on persons who breach, grossly neglect, or recklessly disregard that duty of inquiry. We believe this would be a test that would be next to impossible to invoke.

The duty to investigate, which has been supported by your colleagues on the Senate side, is unrealistic and unfair, particularly when substantial penalties will be meted out for neglect violations. Examples of situations which may realistically give rise to liability would include the small businessman, the farmer or the student who applies for Federal assistance in the same manner as in previous years. But the individual could well be unaware of the change in rules or regulations, announcements in the Federal Register with respect to eligibility and the filing of that claim which would give rise to liability under the legislation as it has been proposed on the Senate side and has been endorsed by the Justice Department.

The program fraud bill goes far beyond the Government contractors about whom members were talking earlier and would apply to any individual or any company that would have a claim against the Government. I would hope the committee might consider narrowing down the scope of this bill signficantly in terms of its reach so that the problems that the committee identifies are addressed and there is not an indiscriminate attack on individuals who may make legitimate claims, all be them inadvertently false, to the Federal Government.

The second category rests on the question of the knowledge of the defendant's actual state of mind. By adopting a definition of knowledge which includes actual knowledge, deliberate ignorance, and reckless disregard for the truth. We think the proposed legislation would reach those individuals who intentionally make false claims as well as persons who evidence personal culpability by trying to avoid the truth.

In sum, Mr. Chairman, we believe that the subcommittee has a serious task before it in trying to fully understand and review the impact of amendments to false claims of legislation on individuals as well as on corporations. In pursuing your public policy, which the section supports, cf finding fraud and focusing on liability of individuals or corporations who have acted in reckless disregard of the truth, a clear signal on liability must be presented to the public and to those enforcing the laws.

I am accompanied today by Mr. Alan Brown who is the chairman of our Program Fraud Committee, and I think he would like to add just a few comments.

Mr. ALAN BROWN. Mr. Chairman, the one distinction in the proposed standard by the Senate committee, the one main distinction on this duty of inquiry, is that in imposing such a duty of inquiry it would abolish the defense that the individual actually believed his claim to be true. We strongly believe with any charge of fraud against a person it should be a defense to that charge if a person acted in good faith and actually believed that his claim was accurate. This would be a valid defense even if a different person in the same circumstances might have done additional checking. This duty of inquiry or gross negligence of a duty of inquiry which a reasonable and prudent man would have under the circumstances, ignores that defense. As a result, even though a person acted totally in good faith, he could be penalized under these bills if later, maybe several years later, an administrative law judge determines that if he had been in that person's circumstances he would have checked further, would have examined the rules further and so forth. We think this result is inappropriate.

We think it is also important to point out that the Government is not without a remedy in these other circumstances. The Government has common law rights to recover money any time it is paid out inappropriately, by mistake or if a person in the Government authorizing the payment were without authority. The Government has many remedies to get back actual overpayments or to avoid payment to the individual.

But what we are talking about under these statutes is penalties, double damages, forfeitures, increased damages being levied against an individual, such penalties should be based on the individual's culpability, state of mind at the time; and, therefore, we have proposed in our statement that the appropriate standard would be if that individual actually knows that the claim is false, acts in reckless disregard of whether the claim is false, for example, if a person has intentionally avoided keeping records so that when he is called upon to account for the amount he has no paperwork that he could check to see whether his claim is accurate or if he acts in reckless disregard of whether it is true or not, for example, by supplying information that he has no basis whatsoever for knowing whether it is accurate, if he just makes up numbers out of the air.

But it should not include the individual who truly believes that his statement is true. He should not be charged with fraud just because someone else thinks he should have checked further.

Ms. WILLIAMS. Thank you, Mr. Chairman. We will be happy to respond to your questions.

[The statement of Karen Hastie Williams follows:]

STATEMENT OF
KAREN HASTIE WILLIAMS
CHAIRMAN
LEGISLATIVE LIAISON COMMITTEE
SECTION OF PUBLIC CONTRACT LAW
AMERICAN BAR ASSOCIATION

Mr. Chairman and members of the Subcommittee, my name is Karen Hastie Williams. I am chairman of the Legislative Liaison Committee of the Section of Public Contract Law of the American Bar Association (ABA). With me today is Alan C. Brown, Chairman of the Section's Procurement Fraud Committee.

We are pleased to testify today on False Claims legislation pending before the Congress, including the Program Fraud Civil Penalties Act of 1985, S.1134. This statement represents the views of the Section but has not been approved by the House of Delegates or Board of Governors of the ABA. As such, it represents only the position of the Section of Public Contract Law and should not be construed as representing the position of the American Bar Association.

As the Committee is well aware, members of the Section of Public Contract Law include a cross-section of lawyers from the private bar, government, corporations and academia. However, the positions of the Section are developed independently as a group of public contract professionals after much study and constructive debate.

Our section has consistently taken the position that legislation to correct abuses of the procurement system and fraudulent actions by contractors is an appropriate objective.

Our concerns have always been addressed to the lack of due process protections to which every citizen of this country is entitled.

I regret that past statements have interpreted our earlier expressions of concern as "resistance" to anti-fraud legislation. I want to assure this Committee that the motivation of our membership is to ensure due process for all concerned. We share the concerns of the Congress for the reduction and prevention of false claims and of program fraud. We seek to resolve fraud problems through appropriate legislation that will correct contractual abuses. We have always supported creative effort to improve government procurement laws and regulations. Our concerns with respect to past legislative solutions were not reflective of any single interest group, but were aimed at protecting the constitutional rights of persons accused of fraud.

As false claims and program fraud legislation is considered, however, it is important to recognize that the potential defendants in proceedings under this bill include individuals, small businesses, and non-profit organizations, as well as major corporations and contractors. The standard of knowledge required for these actions must be carefully considered. The assignment of fraud cases to administrative agencies for adjudication means that these persons will lose the right to a jury trial and other significant protections which have heretofore always been available. We remain concerned that, in this process, certain minimum standards of fairness and due process are maintained.

As the Committee is aware, more than 400 statutes and regulations already provide the Government with criminal, civil and administrative remedies to deal with contractor fraud. Numerous bills have been introduced in the 99th Congress to address these issues.

The Public Contract Law Section has been active in the consideration of S.1134 -- The Program Fraud Civil Remedies Act of 1985. Representatives of the Section testified before the Senate Committee on Government Affairs in connection with that bill. While S.1134 is clearly an improvement over earlier bills, the Section continues to have concerns about the knowledge standard and has voiced concerns regarding that and other aspects of the bill in a November 18, 1985, letter to Senator Roth (Attachments 1 and 2).

Our testimony today will focus on the appropriate knowledge standard, an issue equally applicable to the Program Fraud Bill, as reported from the Senate Committee on Governmental Affairs and to the proposed amendments to the False Claims Act, S.1562 and 1673, H.R.3334. The Program Fraud Bill is conceived as a "mini" False Claims Act, and logically the two measures should incorporate the same standard of intent. Any other result will only generate inequities and encourage forum shopping. Our Section Council will consider the

Administration's proposed False Claims Act amendments at our Midwinter Meeting. We are in the process of preparing comments, and I would request permission to furnish a detailed analysis of the Section's position on those bills to your shortly.

Let me begin by summarizing our Section's views regarding the appropriate standard of knowledge and intent which should be applicable to proceedings under Program Fraud legislation.

First, the proceeding contemplated by bills such as S.1134, is, fundamentally, an action for fraud. Like the existing False Claims Act, the bill authorizes imposition of substantial penalties and double damages on persons who submit false, fraudulent and fictitious claims to the United States. Both the nature of the charge and severity of the penalties dictate that proceedings should not lightly be initiated nor liability unfairly assessed. Whether a person is liable for fraud should hinge on that person's actual state of mind at the time of the alleged offense, and liability should require proof of culpability.

Second, we do not believe that a "specific intent to defraud" the United States should be a necessary element of liability under these bills. Instead, we agree with the overwhelming majority of courts which have ruled that proof of actual knowledge of the falsity is a sufficient prerequisite to liability under the False Claims Act.

Third, in certain circumstances, reckless conduct evincing a disregard for the truth of a statement, or deliberate efforts to shield oneself from knowledge of the falsity of a statement, may reflect sufficient culpability that actual knowledge can be inferred. Adoption of a "reckless disregard for the truth" standard of knowledge would comport with the most liberal interpretation of the False Claims Act, and would adequately protect the United States from persons who attempt to avoid liability for their deceit by deliberate efforts to keep from learning the truth.

Fourth, we strongly believe that efforts to adjudicate charges of fraud by comparison of a person's conduct to undefined and subjective standards or duties, without regard to the person's actual culpability or state of mind, are inappropriate and unfair.

Lastly, mistakes, inadvertence, negligence, and sloppiness are not fraud and should not be treated as fraud or included in the proposed legislation.

These principles are discussed more fully below.

THE PROGRAM FRAUD CIVIL REMEDIES ACT OF 1985 (S.1134)

The proposed Program Fraud Civil Remedies Act of 1985 (S.1134) is intended to create an administrative counterpart to the False Claims Act, 31 U.S.C. §3729, and would authorize administrative penalties and assessments in small fraud cases where the amount involved does not warrant litigation in the District Courts. Sections 802(a)(1) and (2) of S.1134 authorize the assessment of civil penalties of up to $10,000, plus double damages, on any person who makes, presents, submits or causes to be made, presented or submitted to a Federal agency a claim or statement which he knows or has reason to know is false, fictitious or fraudulent. Section 801(a)(6) defines "knows or has reason to know" to mean that the person has actual knowledge of the falsity, or "acts in gross negligence of the duty to make such inquiry as would be reasonable and prudent to conduct under the circumstances to ascertain the true and accurate basis of the claim or statement."

Standard of Knowledge Under The False Claims Act

A starting point for considering the appropriate standard of knowledge under the S.1134 is the substantial body of case law which has developed under the False Claims Act, 31 U.S.C. §3729. The courts today are split among three different views of the appropriate standard of knowledge or intent under that statute.

The most liberal standard of knowledge was adopted by the Eighth Circuit in United States v. Cooperative Grain & Supply Co., 476 F.2d 47 (8th Cir. 1973). In Cooperative Grain, the Court adopted a "constructive knowledge" test and held that recklessness or "carelessness in the extreme" can be deemed to reflect sufficient knowledge or intent to give rise to liability under the False Claims Act.

At the opposite end of the spectrum, both the Fifth and Ninth Circuits continue to require not only actual, rather than constructive, knowledge of the falsity, but also a specific intent to defraud the United States. See United States v. Mead, 426 F.2d 118 (9th Cir. 1970); United States v. National Wholesalers, 236 F.2d 944 (9th Cir. 1956), cert. denied 353 U.S. 930 (1957). This is by no means an outdated or obsolete view. Only four months ago, the Court in Thevenot v. National Flood Insurance Program, ___ F.Supp. ___ (W.D. La. October 10, 1985) reaffirmed the Fifth Circuit rule, stating:

> The requisite intent needed to establish a violation of the False Claims Act is well established in the Fifth Circuit. "To establish a violation of the False Claims Act, the United States must demonstrate, by a preponderance of the evidence, that the defendant possessed guilty knowledge or guilty intent to cheat the government". United States v. Thomas, 709 F.2d 968 (5th Cir. 1983); Peterson v. Weinberger, 508 F.2d 45 (5th Cir. 1975); United States v. Aerodex, 469 F.2d 1003 (5th Cir. 1972). [Emphasis added.]

An overwhelming majority of courts have rejected both of these positions and have continued to follow the middle view that proof of actual knowledge is required under the Act, but specific intent to defraud is not. See, e.g., United States v. Hughes, 585 F.2d 284 (7th Cir. 1978); United States v. Ekelman & Assoc., 532 F.2d 545 (6th Cir. 1976);

United States v. Children's Shelter, Inc., 604 F.Supp. 865 (W.D. Okla. 1985) [stating Tenth Circuit rule]; United States v. Dibona, 614 F.Supp. 40 (E.D. Pa. 1984) [stating Third Circuit rule]; United States v. Alaska, 591 F.Supp. 794 (N.D. Ill. 1984); Alsco-Harvard Fraud Litigation, 523 F.Supp. 790 (D.D.C. 1981). In Ekelman, 532 F.2d at 548, for example, the Sixth Circuit refused to adopt a "recklessness" or "should have known" standard, stating:

> Thus, the law of this Circuit requires a showing of actual knowledge to establish liability under the False Claims Act. This appears to be the preponderant view.

The distinctions between these different views are best explained in Alsco-Harvard, 523 F.Supp. at 806. After identifying the various interpretations, the Court stated:

> The preponderant, and better view, however, is that the Act only requires that the defendant knowingly present a false claim to the Government.
>
> * * *
>
> Despite the fact that plaintiff need only prove that defendants had knowledge of the submission of false claims and not a specific intent to deceive the Government, the United States must prove that defendants had "actual knowledge". It is not enough to allege that defendants knew "or should have known" that certain claims presented to the Government were false, fictitious or fraudulent. [Emphasis added.][1]

---

[1] The predominance of the "actual knowledge" standard under the False Claims Act is recognized in the memorandum submitted for the Hearing record on S.1134 by HHS Inspector General Richard P. Kusserow. See Hearing before the Subcommittee on Oversight of Government Management on S.1134, 99th Cong., 1st Sess. (1985), at 202 [hereafter "Hearing"]. The Kusserow Memorandum identifies the various interpre-

BEST COPY AVAILABLE

THE COOPERATIVE GRAIN DECISION

Although it remains a minority interpretation of only one circuit of the False Claims Act, the *Cooperative Grain* decision has become the principal legal foundation for the various constructive knowledge standards proposed for S.1134. It has been suggested that *Cooperative Grain* both imposes an independent duty to investigate questions of eligibility for Federal programs, and creates liability for double damages and statutory forfeitures for negligent failures to fulfill this duty. This argument substantially overstates the *Cooperative Grain* decision.

In *Cooperative Grain*, a grain storage cooperative, its managing officer, and several grain producers, obtained Federal price support payments for grain which they had purchased rather than grown. The program regulations required that to be eligible, the grain was required to have been grown by the claimant. The issue was whether the defendants "knew" that they were ineligible for price supports at the time they submitted their claims.

> The question here then would be whether the defendants' "clumsiness" or "carelessness and foolishness in the extreme" constitute conduct that the court can deem to create sufficient knowledge or awareness under the False Claims Act to

---

tations, and concludes "The predominant view in most circuits requires actual 'knowledge'." The Memorandum continues by discussing the *Cooperative Grain* decision, concluding, "This minority view has not been widely followed."

be civilly actionable. 476 F.2d at 56.

The evidence did not indicate that the defendants had merely been mistaken about their eligibility or that they had acted in good faith. Several of the defendant producers admitted that they knew that only produced grain was eligible. Id. at 60. Several of the producers had also been officers of the Cooperative and were well familiar with the program. None of the producers had so much as asked the local Commodity Credit Corporation office whether the purchased grain was eligible. Id. The number of farmers who had tried to substitute purchased for produced grain was small. Id. at 61. In the end, the Court of Appeals simply did not believe the defendants' claims of innocence, stating:

> [I]t is incredible that the producers did not know that purchased grain was not eligible for price support. Id. at 60 [emphasis added].

The Court did not hold that the defendants were liable under the False Claims Act because they had been negligent, but, to the contrary, held that the defendants were "a full step beyond negligent misrepresentation". The Court explained:

> The defendants' conduct, as the District Court held, was extremely careless and foolish. That conduct is not only negligent but approaches fraud, an intententional misrepresentation. The intent to deceive of a fraudulent misrepresentation may include a reckless disregard for the truth or falsity of a belief. Id. at 60. [emphasis added.]

Thus, the Cooperative Grain decision stands for the proposition that an "extremely careless" or "reckless" disregard for the truth of a statement is equivalent to actual knowledge of its falsity. The decision does not adopt a "negligence" standard of liability, nor sanction liability for fraud based upon comparison with a subjective "reasonable and prudent" duty of inquiry. Most importantly, the decision does not purport to penalize an individual who fails to read all of the pertinent regulations prior to seeking a benefit from the Government in the absence of proof of some personal culpability or bad faith. The decision does not support the definition of "knows or has reason to know" presently contained in S.1134.

Reckless Disregard For The Truth Is The Appropriate Standard Of Intent Under S.1134

Until the Department of Justice letter to Senator Cohen dated August 2, 1985 (Hearing at 158), the minimum appropriate standard of intent under both the False Claims Act and Program Fraud Civil Penalties Act had been viewed by most parties--including the Justice Department--to be "reckless disregard for the truth". For example, in 1980, the Senate Judiciary Committee approved amendments to the False Claims Act proposed by the Department of Justice which defined knowledge to mean that the person had actual knowledge, or "had constructive knowledge in that the defendant acted in reckless disregard for the truth." S.1981, 96th Cong., 2d

Sess. The Judiciary Committee report on that bill recognized that this standard is sufficient to encompass those "ostriches" who attempt to shield themselves from knowledge of or involvement in a fraud, stating:

> Section 2 of the bill, which is intended to embody all of the requisite elements for liability under the Act, excludes elements of common law fraud such as intent and reliance from this statutory cause of action. The Committee intends that knowledge of falsity shall constitute the basic element giving rise to liability. Section 2 accordingly embraces situations in which the evidence establishes that the defendant had actual knowledge of the falsity, as well as cases in which the defendant had constructive knowledge of the falsity in that he acted in reckless disregard of the truth. With regard to this constructive knowledge standard, the language of the bill is sufficiently broad in scope so as to encompass the person who seeks payment from the government without regard to his eligibility and with indifference for the requirements of eligibility, or who certifies information to the government in support of his claim with neither personal knowledge of its accuracy nor reasonable investigative efforts. It also encompasses the individual who would hide behind a shield of self-imposed ignorance.
>
> S.Rep. No. 96-615, 96th Cong., 2d Sess. (1980) at 5-6 [emphasis added.]

Again in 1982, Assistant Attorney General J. Paul McGrath, testifying in support of S.1780--the proposed Program Fraud Civil Penalties Act--explained the "knowledge" requirement as follows:

> This element of scienter--in this context knowledge of the falsity of the claim or statement--encompasses both actual knowledge of the falsity and conduct evincing a reckless disregard of whether or not a given representation is false. In this respect, the scienter provisions of the bill

> parallel those of the False Claims Act.... S.1780 thus in our view wisely includes reckless disregard of the truth as part of the scienter requirement of the bill. [emphasis added.]

Most recently, in the section-by-section analysis submitted by the Attorney General to the Vice President on September 16, 1985, with the Administration's proposed False Claims Act Amendments, the view was again expressed that "knows or had reason to know" means "reckless disregard" for the truth. The analysis states:

> Under the amendment, a contractor who knew that a claim was false, or who acted in reckless disregard of the truth in submitting the false claim, would be equally liable. The amendment repudiates a requirement that the government prove specific intent to defraud, as is required at common law. We believe this is the better view of the drafters of the original act and is the majority view in the courts today.

Indeed, the negligence or "reasonable and prudent" standard currently contained in S.1134 is inconsistent with Assistant Attorney General Willard's testimony on this bill. Mr. Willard, in defining the "knows or has reason to know" standard, testified:

> We don't regard that as being a specific intent requirement at all. We think it does require something more than an innocent mistake. It does require a showing of some kind of deliberate act or fault on the part of the individual. Hearing at 9 [emphasis added].

In providing examples of "reason to know," Mr. Willard continued:

> I think it would include a situation, for

> example, where a responsible person deliberately insulated himself from knowledge by structuring the corporate affairs in a way that he was deliberately shielded from knowledge of the falsity of a claim or statement submitted by his subordinates.
>
> * * *
>
> But another situation would be where the responsible person was reckless in submitting a claim without taking the appropriate steps to determine whether or not it was false. Hearing at 15. [emphasis added.]

Mr. Willard's testimony supports the conclusion that "reason to know" should require some deliberate or conscious act, and properly encompasses reckless disregard of truth or falsity and deliberate ignorance.

The Justice Department in its August 2 letter, advocated for the first time a substantially reduced negligence standard. The Department would not only apply a "gross negligence standard but would ignore the individual's culpability or state of mind by inventing a subjective "duty of inquiry." (Hearing at 160). This standard, if adopted, would significantly decrease the standard of intent necessary to impose penalties on persons for false claims or statements over that existing at common law or under the False Claims Act.

An excellent discussion of the distinction between "negligence" and "knowledge" is contained in Computer Systems Eng., Inc. v. Quantel Corp., 571 F.Supp. 1365, 1374-77 (D. Mass. 1983), aff'd 740 F.2d 59, 67-68 (1st Cir. 1984).

> Negligence--even gross negligence--is determined by an objective standard. In determining negligence, we use the hypo-

> thetical conduct of a creature of the law--an ordinary prudent person--as a standard for comparison of the person being judged. By that standard, one who should have known a fact but did not is negligent. In contrast, the standard prescribed by "willful" as well as the standard prescribed by "knowing", is a state-of-mind standard that requires the fact finder to determine not whether a defendant should have had that state of mind, but whether in fact the defendant did have that state of mind. Even though evidence that an ordinarily prudent person would have known, and that defendant should have known, may be received as circumstantial evidence that the defendant did know, the question the fact finder must answer is whether in fact the defendant did know.
>
> * * *
>
> To prove that the defendant committed a knowing violation by fraud, the plaintiff may show that agents of the defendant knew that the fact they represented to be true was not true. Similarly, to prove that the defendant committed a willful violation by fraud, the plaintiff may prove that agents of the defendant knew that they did not know whether the fact represented was true or false--that they made the representation without knowing whether it was true or false and with reckless disregard for whether it was true or false. Though not the equivalent of proving the state of mind of knowing the falsity of the fact represented, this is nevertheless proof of a culpable state of mind--the state of mind of willful disregard for truth or falsity of the fact represented. [Citations and parentheticals omitted, emphasis added.]

The necessity of focusing on the defendant's actual state of mind, rather than on a "reasonable and prudent man" standard, is plain from the definitions of "culpability".

"recklessly" and "knowledge" in the Model Penal Code, §202. The Model Penal Code defines four decreasing stages of culpability: (a) "Purposely", (b) "Knowingly", (c) "Recklessly", and (4) "Negligently." "Recklessly" is defined as follows:

> A person acts recklessly with respect to a material element of an offense when he consciously disregards a substantial and unjustifiable risk that the material element exists or will result from his conduct. The risk must be of such a nature and degree that, considering the nature and purpose of the actor's conduct and the circumstances known to him, its disregard involves a gross deviation from a standard of conduct that a law-abiding person would observe in the actor's situation. [emphasis added.]

There is a substantial body of case law equating "reckless disregard" with knowledge in a variety of contexts. Among other things, reckless disregard of the truth is sufficient to impose liability for False Statements under 18 U.S.C. §1001 and False Claims under 18 U.S.C. §287 (see United States v. White, 765 F.2d 1469 (11th Cir. 1985)) and mail fraud under 18 U.S.C. §1341 (see United States v. Dick, 744 F.2d 546 (7th Cir. 1984)); to prevent discharge of a debt in bankruptcy (see Birmingham Trust National Bank v. Case, 755 F.2d 1474 (11th Cir. 1985 ["reckless disregard" equals "false representation"]); to challenge the validity of an affidavit supporting a search warrant (see Franks v. Delaware, 438 U.S. 154 (1978) and United States v. Helmel, 769 F.2d 1306 (8th Cir. 1985)); and to establish liability for libel or slander (see McDonald

v. Smith, 105 S.Ct. 2787 (1985) and New York Times v. Sullivan, 376 U.S. 254 (1965) [reckless disregard equals actual malice]).

Similarly, "knowledge" is defined in Model Penal Code §2.02(7) as follows:

> When knowledge of the existence of a particular fact is an element of an offense, such knowledge is established if a person is aware of a high probability of its existence, unless he actually believes that it does not exist. [emphasis added.]

This standard has been applied by the Supreme Court and other courts in a variety of contexts. See, e.g., Turner v. United States, 396 U.S. 398, 416 n. 20 (1970); Leary v. United States, 395 U.S. 6, 45 n. 93 (1969); United States v. Restrepo-Granda, 575 F.2d 524, 528 (5th Cir.), cert. denied, 439 U.S. 935 (1978). S.1134, on the other hand, would permit liability to be premised on constructive knowledge, even if the person actually believed that his statements were true.

In Restrepo-Granda, the Fifth Circuit also held that "deliberate ignorance" was encompassed within the broader requirement of knowledge, and defined it as follows:

> The term as used denotes a conscious effort to avoid positive knowledge of a fact which is an element of an offense charged, the defendant choosing to remain ignorant so that he can plead lack of positive knowledge in the event he should be caught.

Many other decisions have adopted and explained the "deliberate ignorance" test. For example, in United States v. Jewell, 532 F.2d 697 (9th Cir.) (en banc), cert. denied, 426 U.S. 951 (1976) [on which the so-called "Jewell instruction" on deliberate ignorance is based], defendant was charged with "knowing" possession of a controlled substance after he was arrested driving an automobile containing 110 pounds of marijuana in a secret compartment. Defendant testified that he did not know the drugs were in the car. Evidence indicated, though, that he was aware of the secret compartment and of facts suggesting drugs were present, but had "deliberately avoided positive knowledge of the presence of the contraband to avoid responsibility in the event of discovery." Relying in part on the Model Penal Code, the Court did not hesitate to find that the "knowledge" element of the statute had been satisfied. The Court explained the "deliberate ignorance" rule as follows:

> The substantive justification for the rule is that deliberate ignorance and positive knowledge are equally culpable. The textual justification is that in common understanding one "knows" facts of which he is less than absolutely certain. To act "knowingly" therefore, is not necessarily to act only with positive knowledge, but also to act with an awareness of a high probability of the existence of the fact in question. When such awareness is present, "positive" knowledge is not required. 532 F.2d at 700.

See also, United States v. MacKenzie, 777 F.2d 811, 818-19 (2d Cir. 1985); United States v. Henderson, 721 F.2d 276, 277-279 (9th Cir. 1983).

The Model Penal Code's definition of "negligently", on the other hand, eliminates the requirement that the person "consciously disregard" the risk, and substitutes instead the mere requirement that he "should be aware" of the risk. "Negligence" also eliminates the defense that the person actually believes that his statement is truthful. Thus negligence requires no examination of the person's actual state of mind, and penalties may be imposed on a person who, while acting in good faith, fails to live up to a "reasonable man" standard of conduct. This is the standard adopted by S.1134.

THE PROPOSED STANDARDS

At least seven different standards of knowledge have been proposed for S.1134. These proposals can generally be separated into two groupings. Several of the proposals are similar in that they would impose a "duty of inquiry" on persons submitting statements or claims to the United States, and would impose substantial liability on persons who breach, "grossly neglect" or "recklessly disregard" that duty of inquiry. We believe this test is inappropriate in legislation such as S.1134.

Application of a subjective "duty of inquiry" circumvents any examination of the defendant's actual state of mind or culpability, and penalties could be imposed if a person is found to have violated this undefined duty, even though the person actually believed his statements to be true and acted in good faith. In effect, each of these standards would eliminate from the Model Penal Code definition of "knowledge" the caveat that, regardless of the circumstances, a person should not be deemed to "know" a fact which he honestly and actually believes does not exist.

The "duty to investigate" sought to be imposed by S.1134 is unrealistic and unfair, particularly when substantial penalties will be meted out for negligent violations of the duty. As Justice Jackson stated long ago:

> To my mind, it is an absurdity to hold that every farmer who insures his crops knows what the Federal Register contains or even knows that there is such a publication. If he were to peruse this voluminous and dull publication as it is issued from time to time in order to make sure whether anything has been promulgated that affects his rights, he would never get time to plant any crops. Federal Crop Ins. Corp. v. Merrill, 332 U.S. 380, 387 (1947) [dissenting opinion].

Examples of situations which may realistically give rise to liability under S.1134 include the small businessman, farmer, or student, who applies for Federal assistance in the same manner as in previous years, but is unaware of a change in rules which render him ineligible. The person does not know that his claim is false, and has no reason to doubt the validity and accuracy of his claim, yet he could easily have verified his eligibility by checking publicly available regulations. While this person could be characterized as "grossly negligent," he has no intent or culpability and has not in any sense defrauded or attempted to defraud the United States. Nonetheless, this person could be subjected to substantial penalties under S.1134.

Similarly, a corporate officer who, relying in good faith on his subordinates, signs a claim which he truly believes is accurate, could later be severely penalized for "fraud" under S.1134 if a hearing examiner, months or years later, determines that a "reasonable and prudent" person would have checked further. This result is unfair and unwarranted.

The appropriate standard must properly rest the question of knowledge on the defendant's actual state of mind. By adopting a definition of knowledge which includes (1) actual knowledge, (2) deliberate ignorance, and (3) reckless disregard for the truth, the proposed legislation would reach those individuals who intentionally make false claims, as well as persons who evidence personal culpability by a reckless disregard for the truth of their statements, or by deliberate efforts to avoid learning the truth. For example, an individual who purposely provides information on an application with no basis whatsoever for knowing whether it is accurate or not, or a businessman who deliberately avoids maintaining records and is thereby unable to verify his claim, have committed an intentional act which is more than sufficient to reflect a culpable state of mind. We agree that these persons should appropriately be encompassed within the proposed legislation. At the same time, basing liability on the defendant's state of mind rather than a subjective "duty" test will protect individuals who, while inattentive, actually believe in good faith that their statements are true.

A more appropriate standard under S.1134 and any false claims proposal would be the following definition of knowledge:

> "knows or has reason to know" means that a person, with respect to a fact --
>
> (A) has actual knowledge of the fact; or
>
> (B) acts in deliberate ignorance of the truth or falsity of the fact; or
>
> (C) acts with reckless disregard of the truth or falsity of the fact.

This definition provides both the greatest clarity and sufficient breadth to include all persons who attempt to wrongfully obtain money or property from the United States.

As this Subcommittee continues its deliberations on false claims and fraud legislation, the American Bar Association encourages you to examine closely the question of scienter. As lawyers we are deeply concerned that wrongdoers be brought to justice but wish fervently to protect the rights of innocent parties.

Prior to the adoption of any new legislation, we urge you first to consider the plethora of existing statutory restraints applicable to taxpayers, federal and military employees, grantees, contractors, and all who receive some form of government assistance. We are preparing a detailed analysis of H.R.3334, the Administration's False Claims Act and would request that we be permitted to submit it for the Record within the next few weeks.

The ABA looks forward to working with the members of the Subcommittee and your colleagues in the House to explore these important issues.

We appreciate the opportunity to appear here today and would be pleased to respond to any questions you may have.

* * *

Mr. GLICKMAN. Do you have any thoughts with reference to my previous comments with Mr. Breger in reference to the administrative law issues?

Ms. WILLIAMS. We strongly support the position that the Administrative Conference has taken on the need for independent judges and in previous testimony we have supported the use of ALJ's in agencies that do not currently use them. We agree with your analysis that it would be important that agencies who use ALJ's use them so that the independence that currently attaches to an ALJ as a decisionmaker would carry over to the program fraud area. Specifically, with respect to the Department of Defense, the issue has arisen in a number of instances in identifying hearing examiners to be the equivalent of an ALJ. The indicia of the designee as spelled out, for example, in the Cohen bill, would be one way of addressing these concerns. Using the due process protections of the Administrative Procedure Act would also be another way of doing it.

Mr. GLICKMAN. The basic requirements of the Administrative Procedure Act and whatever format was used by the Department of Defense.

Ms. WILLIAMS. Exactly. The legislation would specify, if someone was designated, that an ALJ designee would be cloaked in the procedural protections—the due process protections—of the APA.

Mr. BROWN. With regard to the questions you raised earlier regarding military officers, I think our concern has been directed at making sure the hearing examiners are truly a body of independent, preferably full-time hearing examiners who have no other function serving as part-time procurement officials so they should not serve as hearing examiners on program fraud hearings on contracts; and I suppose there is a question whether military officers, because of the line of command and so forth, could ever have a sufficient independence to be acting as hearing examiners in that context.

Mr. GLICKMAN. I think that is an important question.

The other one is the qui tam provisions. Do you support the qui tam provisions that we talked about earlier, the expanded provisions that Mr. Berman and others talked about and as discussed by Mr. Gravitt's attorney?

Ms. WILLIAMS. Mr. Chairman, the American Bar Association and the section have not taken a formal position on the qui tam provisions. I will be happy to submit the position for the record for you after the Public Contract Law Council has had a chance to look at the provisions in pending bills.

Mr. GLICKMAN. My thinking is that something along those lines is going to make it into whatever bill we produce over here, so you ought to give us your thoughts on that.

Ms. WILLIAMS. We will be happy to.

Mr. GLICKMAN. Thank you very much.

That concludes the hearing today. We will no doubt be pursuing this subject further, however.

The hearing today is adjourned.

[Whereupon, at 2:20 p.m., the subcommittee was adjourned.]

[The following statements were submitted to the Subcommittee on Administrative Law and Governmental for inclusion in the record of the hearings held on February 5 and 6, 1982, relating to false claims:]

STATEMENT

NATIONAL ASSOCIATION OF MANUFACTURERS

SUBMITTED TO
THE SUBCOMMITTEE ON ADMINISTRATIVE LAW
AND GOVERNMENTAL RELATIONS

COMMITTEE ON THE JUDICIARY
U.S. HOUSE OF REPRESENTATIVES

FEBRUARY 20, 1986

Thank you for agreeing to hold open the record for your recent hearings regarding the problems of fraud in government programs, and various legislative proposals offered as remedies. Since you have before you several legislative proposals and since Chairman Glickman indicated during the hearing that he would be offering a new proposal, this statement will serve more to deal with the issues, concerns and alternative suggestions.

The National Association of Manufacturers is a voluntary business association of over 13,000 corporations, large and small, located in every state. Members range in size from the very large to over 9,000 smaller manufacturing firms, each with an employee base of less than 500. NAM member companies employ 85 percent of all workers in manufacturing and produce 80 percent of the nation's manufactured goods. NAM is affiliated with an additional 158,000 businesses through its Associations Council and National Industrial Council.

Because the membership of the NAM is representative of all types of manufacturers, we believe we can offer a unique perspective on this issue. Certainly, fraud of any sort against the government, or any consumer, is deplorable and cannot be condoned. In the case of defrauding the government, which is the present concern of the Subcommittee, it is all taxpayers, corporate and individual, who are the ultimate losers.

All acts of substantiated and provable fraud should and must be prosecuted to the extent feasible. The NAM recognizes that much too often the amount of money involved which would be recoverable is not sufficient for a local U.S. Attorney to pursue a court action and agrees in principle with the thrust of a majority of the bills proposed so far that administrative remedies may be the best means for prevention of fraud involving relatively small sums of money.

We take strong exception, however, to proposals which threaten basic civil liberties and the right to due process for individuals as well as corporations or which would otherwise hamper the efficient operation of normal business procedures.

One of the most serious threats to legitimate businessmen, in many of the proposed legislative solutions, is the definition of the standard of knowledge. At a minimum, the standard of knowledge for a successful finding of fraud should be "reckless disregard for the truth." As detailed in the statement by the Section of Public Contract Law of the American Bar Association, the case law defining "reckless disregard" contains the act of "deliberate ignorance." Within its scope, "knows or has reason to know" language would be a reasonable standard for legislation such as H.R.3317, and H.R.3334, and would seem to comply with the reckless disregard criteria. However, the definition is refined to lower the standard to one of "gross negligence," which would not necessitate a finding of intent to be held liable; further, "gross negligence" includes a failure to pursue a line of inquiry regarding the complete accuracy of a statement made to the government. You can certainly appreciate the fact that most businessmen, like most Members of Congress, rely on subordinates or other sources of information believed to be trustworthy. This is how it should be. Neither a manager or corporate officer in a large corporation nor the head of a small business has the time personally to oversee and review the derivation of every fact or figure for a document, yet the standard proposed in these bills would hold him personally liable for fines.

Other major difficulties with the proposals are in the areas of due process and civil liberties, which would be abridged by the granting of subpoena power. At the hearing, the Inspector General of the Department of Health and Human Services testified to the benefits of the Civil Monetary Penalties Law (CMPL) applicable to Medicare and Medicaid. Please note that CMPL does not grant any testimonial subpoena power. The granting of testimonial subpoena power to Inspectors General should not be undertaken without careful and considerate deliberation, particularly since the experience under CMPL shows it is not necessary. Since the solution to fraud contained in the proposed bills relies on administrative proceedings, the accused no longer would have the protections of a court or a grand jury to ensure that his civil liberties are not violated during the investigation or the proceedings.

It is in the best interest of justice that the right to a full hearing should attach as a matter of right and would have to be waived instead of requested since it is conceivable that someone with insufficient knowledge of the process could be reluctant to exercise this right. In addition, full discovery rights must be available to the accused and not limited, as stated in Section 803(f)(3)(B)(ii) of S.1134, "to the extent that the hearing examiner determines that such discovery is necessary for the expeditious, fair, and reasonable consideration of the issues." In light of the fact that the government's burden of proof would be lowered from the present "clear and convincing evidence" standard to one of "a preponderance of the evidence," discovery rights take on added importance.

While all of the current bills offered claim to be civil, and not criminal, in nature, S.1562 allows for the arrest and posting of bail for a person accused of fraud. By implication, this provides for imprisonment of the accused if he cannot post bail. This is especially threatening given the fact that intent to defraud is not a necessary element for a finding of fraud.

Additionally, appeals of agency findings must be made more accessible than to the U.S. Court of Appeals. While it is true that a common intent of the current proliferation of fraud legislation is to relieve the District Court caseload and to secure some sort of action since many local U.S. Attorneys do not consider allegations of fraud of less than $100,000 worth the time and effort of prosecution, perhaps the Administrative Law and Governmental Relations Subcommittee could arrive at a compromise whereby appeals could be made to the District Court.

Regarding revision of the current _qui tam_ provisions of the False Claims Act, the NAM would caution the Subcommittee against a full-scale reimplementation. Although in certain cases this course of action may be the only recourse to initiate fraud proceedings, care must be taken to ensure that harassment or frivolous lawsuits do not proliferate. A key ingredient would include a prohibition against _qui tam_ suits based on information currently under review or resolved by governmental entities and/or has become public information. The impact of _qui tam_ has not been adequately reviewed to determine its effectiveness and until that is done the existing provisions should not be broadened.

Since the full Judiciary Committee will soon begin consideration of reforming the Racketeer Influenced Corrupt Organizations Act (RICO), it is in a good position to understand the importance of resisting the temptation to rush into the hasty implementation of ill-conceived legislative solutions to such a complex issue. RICO was enacted in 1970 with the uncontroversial goal of weeding out organized crime from American businesses. However, legitimate businessmen with absolutely no ties to organized crime recently have become subject to the harsh civil provisions of the RICO statute due to broad language which was intended to make prosecutions easier. The courts have stated that their "hands are tied," and it is up to Congress to correct the original statute to prevent continued misuse of the law. Let us not make the same mistake with anti-fraud legislation.

In summary, the National Association of Manufacturers, on behalf of its membership, supports the elimination of waste and fraud from all government programs as a means of ensuring the wise and efficient use of tax monies paid into the national treasury. However, care must be exercised during the legislative process so that normal business procedures are not jeopardized and civil liberties and due process rights are not violated. We appreciate the careful approach which the Subcommittee indicated it will take during the recent hearings and the opportunity to submit this statement for the record. We are certainly willing and available to work with you and your staff to develop a well-reasoned and balanced approach to the problem of government program fraud.

NATIONAL CONFERENCE
OF
BOARDS OF CONTRACT APPEALS MEMBERS
P.O. BOX 23330 • WASHINGTON, DC 20026-3330

February 14, 1986

Honorable Dan Glickman
Chairman, Subcommittee on Administrative Law
  and Government Relations
House Judiciary Committee
Room B351 A Rayburn House Office Building
Washington, DC 20515

Dear Congressman Glickman:

On behalf of the National Conference of Boards of Contract Appeals Members, thank you for the opportunity to comment on H.R. 3335, the Program Fraud Civil Penalties Act of 1985. We would like our comments to become part of the permanent record, if you deem it appropriate.

The Conference is an organization comprised of administrative judges serving on boards of contract appeals. As program fraud cases will arise in areas related to the jurisdiction conferred on boards of contract appeals by the Contract Disputes Act of 1978 (the Act), 41 U.S.C. § 601-613, we believe that the boards could be of service in providing administrative due process in program fraud cases.

In passing the Act, Congress was mindful of contract claims as a potential source of fraud, as section 5 of the Act, 41 U.S.C. § 604, "Fraudulent Claims," is expressly addressed to that subject. Under current procedures, boards do not finally adjudicate alleged infractions arising under section 5. However, judges on boards have routinely dealt with issues involving fraud in contract performance under the standard "Inspections" clause. That clause, which has been substantially unchanged for decades, provides that final contract acceptance will not be conclusive where fraud is involved. Boards have also routinely dealt with contract cost principles, which we believe to be an area of concern under H.R. 3335. Thus, we believe contract disputes should be a subject of significant consideration in creating a legislative plan for program fraud, and that judges on the boards of contract appeals should play a role in that plan.

Specifically, we believe the administrative judges serving on the boards should be expressly included in section 801(a)(8) of H.R. 3335 under the definition of "hearing examiner." The boards presently adjudicate contract appeals involving billions of dollars annually and have extensive experience conducting hearings and providing fair and impartial administrative due process. We note that a parallel bill, S. 1134, the Program Civil Remedies Act of 1985, contains a more detailed definition of hearing examiner, including specific reference to protection from removal. A recent GAO report* raised the issue of removal protection for board members under the Act. Under the GAO interpretation, the administrative judges serving on boards of contract appeals would not meet the criteria of S. 1134. We not believe the Act was properly interpreted in the GAO report. See the memorandum enclosed as Exhibit A supporting the Conference's position that board members have retention rights under the Act. However, it has been reported that the Senate Governmental Affairs Committee is submitting legislation to clarify the Act so that board members would unquestionably have the same retention rights as administrative law judges. See Exhibit B enclosed. Thus, even under the GAO interpretation of the Act and the Senate's definition of hearing examiner, board members would be qualified to adjudicate program fraud cases if the clarifying amendment is enacted before or concurrent with H.R. 3335.

We also believe that the boards of contract appeals are appropriate forums to resolve program fraud cases for reasons of administrative efficiency as well as expertise. Initially, at least, we would expect the caseload to be relatively small and capable of being absorbed by the existing boards without increasing the number of administrative judges, with the possible exception of the Armed Services Board of Contract Appeals. Thus, there would be no need to create a new forum to provide administrative due process, and no corresponding need to dismantle an elaborate administrative mechanism if experience later proved the need for a different approach. Additionally, agencies with boards of contract appeals but no administrative law judges could use their boards for program fraud cases.

---

*Report to the Chairman, Committee on Governmental Affairs, United States Senate, The Armed Services Board of Contract Appeals Has Operated Independently, GAO/NSIAD-85-102, September 23, 1985.

Accordingly, the Conference respectfully suggests that the first sentence of the definition of hearing examiner in Section 801(a)(8) of H.R. 3335 be amended to read as follows:

> 'hearing examiner' means an administrative law judge, a member of a board of contract appeals appointed pursuant to 41 U.S.C. 607, or ...

We believe this amendment will serve to implement the objectives of H.R. 3335. If the Conference can provide additional information or if a meeting with you or your staff is deemed advisable, please call me at 453-2890.

Sincerely,

Carroll C. Dicus Jr
Carroll C. Dicus, Jr.
President

Enclosures

cc: Janet Sue Potts, Esq., w/encls.

Memorandum on Removal Of BCA Members Under the
Contract Disputes Act of 1978

The specific statutory language upon which this memorandum is focussed appears in Sec. 8 (b) (1) of the Contract Disputes Act of 1978 (the Act), 41 U.S.C. 607 (b) (1):

> "...members of agency boards shall be selected and appointed to serve in the same manner as hearing examiners appointed pursuant to section 3105 of title 5 of the United States Code..."

A recent GAO report[1] ponders the Congressional intention behind this language, while noting that use of "to serve" may indicate "...a Congressional reliance more upon the manner of service, e.g., the rendering of quasi-judicial opinions without threat of the member being summarily removed..."[2] Thus, while specifically questioning the position espoused by the Conference elsewhere in the report,[3] the GAO echoes that position in the above quote.

The GAO report[4] also notes the legislative intent to ensure independence so that board members "...would not be subject to direction or control by procurement agency authorities."[5]

1/ Report to the Chairman, Committee on Governmental Affairs, United States Senate, The Armed Services Board of Contract Appeals Has Operated Independently, GAO/NSIAD-85-102, September 23, 1985.

2/ Id. at 14.

3/ Id. at 16.

4/ Id. at 18.

5/ S. Rep No. 95-118, 95 Cong., 2nd Sess. 22, reprinted in 1978 U.S. CODE CONG. & AD.NEWS 5257.

The GAO report concludes, however, that it was "not implausible" Congress intended independence to come about solely through the appointment of candidates who show promise of acting independently.[6] We submit that it is implausible Congress relied solely upon appointment of independent-minded people to be board members as a dependable means of ensuring independence in the decision-making process. A matter as crucial to the objectives of the Contract Disputes Act as the independence of boards - it is the "principal purpose" behind emulating the administrative law judge system[7] - could not logically be implied to rest upon anything as elusive as the ability to predict future independence of candidates during the selection and appointment process.

The Conference also finds support for its position in the Congressional intention that the administrative law judge system, for which removal protection is a keystone, was "...perceived as a model for assuring [the] requisite independence. The intent [of the Act] is to establish a corps of contract appeals board memebers comparable to that system."[8] Moreover, the Office of Personnel Management originally supported our reading of the Act and specifically proposed removal procedures before the Merit Systems Protection Board in 1979 (see Exhibit 1).

---

[6] GAO Report, supra at 16.

[7] S. Rep., supra at 24, 5258.

[8] Id.

The House Report also places emphasis on independence and refers to new standards for "selection [and] tenure" in the bill to increase independence. It goes on to state "...[t]hese boards will function with the independencence of trial courts..."[9/] The House Report also incorporates a comment from HUD that a manifestation of Board independence "...is that there has been no political interference in their operations..."[10/]

The intention to make boards independent is antithetical to continuation of their agencies right to remove individual judges without a hearing or a showing of good cause. Removal protection of the type afforded to administrative law judges is essential to ensuring independence. Without it, an agency has an imposing weapon with which it can easily reverse the independence attained through the most successful of selection procedures - by simply firing judges whose decisions they disagree with until the agency gets the desired mindset on its board. We believe the many statements about independence in the committee reports can reasonably be read in context only as embracing removal protection for administrative judges serving on boards of contract appeals.

While the reports constitute the most persuasive portion of the legislative history, other sections reinforce the emphasis on independence. In the Senate hearings, Senator Chiles discussed

---

[9/] H.R. 1556, 95th Cong., 2d Sess. 22.

[10/] Id. at 71.

the role of the Office of Federal Procurement Policy, and the discontinuance of boards based solely on workload and not displeasure with the way cases are decided.[11] See also Senator Metzenbaum's opening statement relative to the board's increased independence from their agencies.[12] The hearings also contain statements from represenatives of the American Bar Association[13] and the Associated General Contractors[14] to the effect that board independence is necessary. The House hearings contain testimony on behalf of the Justice Department supporting the need for independence.[15]

Finally, in the Senate debates, Senator Byrd "[a] major thrust of [the Act] is to make agency boards more prestigious and independent."[16]

On balance , we believe the foregoing amply demonstrates

11/ Contract Disputes Act of 1978: Joint Hearings Before the Subcommittee on Federal Spending Practices and Open Government of the Committee on Governmental Affairs and the Subcommittee on Citizens and Shareholders Rights and Remedies of the Committee on the Judiciary, United States Senate, on S. 2787, S. 3178, 95th Cong. 2d Sess. (June 14 and 20, 1978) at 79-80.

12/ Id. at 4.

13/ Id. at 125.

14/ Id. at 144.

15/ Hearings Before the Subcommitte on Administrative Law and Governmental Relations of the Committee on the Judiciary, House of Representatives, 95th Cong., 1st Sess. on H.R. 664 and Related Bills (November 10 and 11, 1977) at 97.

16/ 43 CONG. REC. S 18541 (daily ed. Oct.12, 1978).

Congressional concern about board independence, and the legislative intent that board independence be ensured. It is n possible to ensure independence unless the administrative judges serving on those boards know that a decision causing agency ire will not result in summary dismissal. Thus, we believe the original intent of the Act should be clearly implemented by an amendment specifically providing the same removal protection to board members as administrative law judges now enjoy, for unless Congress acts, the Office of Personnel Management has left no doubt that it will continue to treat board memebers as subject to summary dismissal.

United States of America
**Office of
Personnel Management** Washington, D.C. 20415

JUL 11 1979

Honorable James T. McIntyre, Jr.
Director, Office of Management
  and Budget
Old Executive Office Building
17th and Pennsylvania Avenue, N.W.
Washington, D.C. 20500

Subject: Selection, Performance Appraisal, and Personnel Action Procedures for Boards of Contract Appeals

Dear Jim:

This letter discusses the approach recommended to implement the requirement in section 8(b)(1) of the Contract Disputes Act that members of boards of contract appeals be selected and appointed to serve in the same manner as administrative law judges. Its purpose is to provide background information and to support my recommendation that the accompanying letter be sent to all affected agencies.

I. The Statutory Requirements

The Contract Disputes Act of 1978, P.L. 95-563, 92 Stat. 2383, was enacted to provide a fair, balanced and comprehensive statutory system of legal and administrative remedies in resolving Government contract claims.1/ Section 8(b)(1) of that Act provides that the members of agency boards shall be selected and appointed to serve in the same manner as administrative law judges. The purpose of this section is to ensure the independence of contract appeals board members as quasi-judicial officers.2/ Congress' intent was not to require that every detail of the administrative law judge system be adopted but, rather, that a comparable system be established.3/

In implementing this statutory requirement, we have been guided by two principal concerns: (1) protecting the independence of board members; and

---

1/ S. Rep. 95-1118, 95 Cong. 2d Sess. 1 (1978).

2/ S. Rep. *supra*, 24.

3/ *Id.*

(2) providing the regulatory flexibility needed to prevent the reenactment of problems with the current ALJ system. As a result, we strongly believe that board members should remain in the excepted service. Placing them in the competitive service would decrease their independence because agencies would be required to appraise the performance of individual board members.4/ This appraisal would have to be taken into account in any personnel action involving members.5/

Placement of board members in the excepted service provides the regulatory flexibility required to meet the needs of the boards. For example, it allows the use of category rankings described in the interim selection procedures designed by OPM's Personnel Research and Development Center6/; the modification of performance appraisal requirements; and the modification of adverse action and unacceptable performance procedures. This freedom will permit us to set up a system for board of contract appeals members which tracks the system proposed by the Administration for ALJs under the Regulatory Reform Act.

I. Recommended Approach

A. Introduction

The approach that we are recommending results from close collaboration between the Office of Management and Budget (OMB), the Office of Personnel Management (OPM) and the major agencies that are affected by the legislation. After the bill was enacted, the Office of Federal Procurement Policy (OFPP) formed a task force comprised of representatives from the agencies involved and from groups outside Government that had an interest in the legislation. As a result of a series of meetings and of events within OFPP, this task force evolved into a smaller operating group that included 7 representatives of OPM, DOD, Navy, GSA, and OFPP. The approach detailed below and the recommended letter to affected agencies has been reviewed and 6 cleared by these agencies represented in the operating group.

We recommend that a larger work group be appointed to assist in the implementation process. This group, co-chaired by OPM and OFPP, would consist of representatives of all agencies with contract appeals boards. It would serve in an advisory capacity to OPM and OFPP in evaluating options and proposed regulations.

4/ If placed in the competitive service, board members would meet the definition of employee in 5 U.S.C. 4301(2) and would be subject to agency performance appraisals under 5 U.S.C. 4302. It would not be possible to fashion an administrative exemption.

5/ 5 U.S.C. 4302.

6/ A copy is attached.

B. Selection Procedures

1. Interim Procedures

OPM's Personnel Research and Development Center, in cooperation with DOD, GS and the Army Corps of Engineers, has developed interim selection procedures that meet the requirements of section 8(b)(2) of the Contract Disputes Act a the Uniform Guidelines on Employee Selection Procedures. The procedures were developed because DOD, GSA, and the Corps of Engineers needed to fill existing vacancies as quickly as possible. The procedures, which are based on a job analysis, rely on four measures: (1) an evaluation of the candidate's experience; (2) inquiries as to candidate's qualification based on structured questionnaires sent to ten references; (3) an evaluation of the candidate's writing samples; and (4) an interview. Based on these measures, candidates will be placed in one of three categories: adequate, above average, and outstanding by a panel consisting of two board members an an outside expert in contract law (preferably a member of an academic institution). Selection will be made by the head of the agency. A copy of the interim procedures are attached.

It must be stressed that these procedures may only be used for a limited period of time. Although they meet the Uniform Guidelines requirements for interim procedures, they do not meet the requirements for permanent procedures. Thus, unless permanent procedures are developed and are adequately validated, agencies risk a finding that the procedures are in violation of the law.

2. Permanent Criteria Procedures

To establish permanent selection criteria and procedures, it is necessary to secure the services of a contractor. OPM does not have staff with the requisite experience to complete the required work expeditiously. Additionally, if OPM were to conduct the study, it would have to be reimbursed b the agencies for its expenditures because of the prohibiton in its appropriation against spending funds for examining attorneys. Moreover, if the criteria and procedures are challenged, it would be better to have the testimony of an independent contractor.

The funds for the contract will be provided by the DOD. DOD has the largest board and, thus, the greatest stake in the outcome. It is recommended, however, that DOD be reimbursed by these agencies using the selection procedures based on the relative size of their contract appeals boards. It believed that the maximum cost of the contract would be $50,000. OPM will assist in preparing a draft request for proposals and will assist in the selection and the monitoring of the contract.[7]

---

[7] The work group also will be consulted concerning the selection of the contractor.

Once the contractor has completed work, OPM will draft the required regulations with the advice and assistance of OFPP and the task force. These regulations probably will provide that the interagency work group, or a group similar to it, should be used to evaluate the candidates. Administrative support to the work group will probably be provided by DOD. We anticipate that any regulations will be issued jointly by OPM and OFPP.

We believe that the interagency work group or a group similar to it should be used to evaluate the candidates.

C. Performance Appraisals

The performance appraisal issue is the most difficult. On one hand, the boards adamantly oppose any performance appraisal system that places the appraisal responsibility with the agency head. This opposition is grounded on the appearance of effecting the board's independence. On the other hand, some sort of appraisal system is necessary. The importance of appraisals was discussed at length in GAO's report on ALJs. Moreover, the Administration's regulatory reform bill requires that the Administrative Conference conduct appraisals of ALJs. Thus, it would be incongruous and counterproductive to exclude board members from appraisals. A large number of alternatives have been considered by the operating group. It appears that the most feasible approach is to require annual appraisals of board members by the board chairman and to provide for review of these appraisals by a panel of board chairmen. Board chairmen would be evaluated annually by a panel of board chairmen with review by a third party, probably the Director of OFPP. Although this proposal is similar to that for ALJs proposed by the Administration bill, it is opposed by some board chairmen because of their concern about the impartiality of other board chairmen. This is an issue that the interagency task force will have to resolve.

The recommended letter to agencies merely states the concern for board members' independence and the need for designing a system that will safeguard their independence. It also solicits suggestions from the agencies concerned.

D. Unacceptable Performance Actions and Adverse Actions

To protect the independence of board members, we believe that OPM and OMB should, by regulation, extend the procedural protections provided by Chapters 43 and 75 of title 5 to all board members. If this action is not taken, non-preference eligible board members would not receive any of the Chapter 75 protections and would be unable to appeal either a Chapter 75 or Chapter 43 action to the MSPB.

Additionally, we recommend providing, by regulation, that a stay of any proposed action against a board member, pending MSPB's final decision, may be granted by a single member of the MSPB. A stay would be available in any instance where the request was not frivolous. It should be noted, however, that our authority to provide a stay may be questionable. This issue is being researched.

II. Recommended Action

The enclosed letter will alert those agencies who have not been directly involved in the operating group, as well as provide formal communication to the agencies which have been working with OPM and OFPP, of our interest in developing procedures for the selection and appointment of Board of Contract Appeals members. It will set in place the mechanism for resolving the concerns expressed above and for issuing implementing regulations as required by the Contract Disputes Act of 1978. If you would sign the letters and return them to my office, my staff will take care of the ministerial work. If you have any questions, please call me directly or Margery Waxman, General Counsel, OPM, at 632-4632.

Sincerely yours,

Alan K. Campbell
Director

Enclosures

BEST COPY AVAILABLE

seek a court order to use the materials in their own administrative proceedings.

HR 1407, which is sponsored by Rep. John Conyers (D-Mich), would permit attorneys to come into the grand jury room for purposes of advising their clients. Under current law, a grand jury witness must ask to leave the room to consult with his attorney. HR 1407 emphasizes that allowing attorneys into the grand jury room would be only for purposes of giving advice; counsel would not be permitted to engage in advocacy or raise objections to questions made to the witness.

The Senate counterpart to HR 3340 is S 1676, which was introduced at the Administration's request by Senate Judiciary Chairman Thurmond. The committee held a hearing on the bill last year, and heard Associate Deputy Attorney General Jay B. Stephens argue that continued restrictions on federal attorneys' ability to obtain grand jury information frustrates the government's efforts to combat fraud. S 1676 has since been referred from the full committee to Sen Paul Laxalt's (R-Nev) subcommittee on Criminal Law.

Bribes and Gratuities

Senate Judiciary also plans a hearing on the Administration's "bribes and gratuities" bill (S 1675 in the Senate, HR 3336 in the House). The bills, also part of the Administration's package of antifraud proposals, would allow the government to rescind a contract tainted by a bribe or gratuity, retain any benefits received, and assess damages against the contractor.

The hearing will focus on due process issues, a Judiciary staffer said. Citing recent allegations of bribery in connection with submarine contracts, he pointed out that, under S 1675, the government could keep the submarine, refuse to pay the contractor, and then levy a penalty ten times the amount of the bribes. "This may be an unconstitutional taking," he observed. Nevertheless, the committee consensus is that there must be a remedy, if not this one than another, for the government in such cases.

On the House side, the Government Operations Committee is expected to hold further hearings on the Paradyne Corporation's performance of major ADP contracts for the Social Security Administration. Paradyne Chairman Robert Wiggins and eight current and former executives have been indicted on charges of conspiracy to defraud the government. The company and a former vice president were also charged with bribing a Social Security Administration official in return for related software contracts.

Contract Disputes Act

The Administration has proposed amending the Contract Disputes Act to make the Claims Court the exclusive forum for bid protest suits. The Administration's bills (S 1674 in the Senate, HR 3337 in the House) would oust the federal district courts of their *Scanwell* jurisdiction. The Senate Judiciary Subcommittee on Courts is planning to hold a hearing on this subject this Spring; no action is planned on the House side at this time.

Meanwhile, the Senate Governmental Affairs is drafting legislation that would give members of the boards of contract appeals added protection against removal, according to a staff member. The measure would amend the Disputes Act to provide that board members would be equivalent to administrative law judges and would enjoy the same protection against removal. GAO, in a study requested by the committee last year reported that the Armed Services Board of Contract Appeals was operating independently, although its members were not completely insulated from agency pressures.

On the House side, Rep. Thomas Kindness (R-OH) will likely try one more time to amend the Contract Disputes Act's certification requirement. "We want to work out something acceptable to the Justice Department," an aide said. "We don't want a veto." In 1983 both the House and Senate passed legislation to do away with the certification requirement, only to see President Reagan veto the bill.

The Justice Department and DOD continue to oppose a complete elimination of certification, the staffer noted. Consequently, Kindness is working with industry groups and the ABA Public Contract Law Section on a "veto-proof" bill that would be acceptable to the Administration. Kindness wants to avoid a lengthy amendment process at the subcommittee level that would sabotage the bill's chances in a short congressional session.

Product Liability

The House Judiciary Subcommittee on Administrative Law last year held a hearing on proposals to expand product liability indemnification for government contractors. HR 1623, which is sponsored by Kindness, would set up a system to indemnify contractors for product liability losses that exceed reasonably available insurance. The bill also would provide for an "equitable reduction" of contractor liability, based on the proportion of fault attributable to the government. Grassley is sponsoring a similar measure (S 1254) in the Senate.

During last year's hearing, Rep. Glickman challenged contractors to come up with "compelling reasons" to pass HR 1623. House Judiciary Committee staffers say they have received no response from industry providing those reasons.

It will be even more difficult to move HR 1623 this year, a staffer commented. One concern is how indemnification authority would be provided, in light of Gramm-Rudman, he said. In addition, there is still a general anti-contractor climate on Capitol Hill, he noted. "That is the greatest hurdle notwithstanding the merits of the [bill]."

Moreover, the subcommittee has a full agenda, including authorization bills for the Justice Department, the Administrative Conference of the U.S., and the Foreign Claims Settlement Commission. Consequently, further work on HR 1623 is unlikely in this short legislative session.

Prospects for passage of an indemnification bill are likely to further diminish after this year, which will be Kindness' last in the House. The Ohio Republican will relinquish his House seat to challenge incumbent Sen Glenn, a Judiciary Committee staffer noted.

Contracting Out

An issue which continues to be a point of contention between federal employee unions, agencies, and contractors, i.e., turning so-called "commercial activities" performed by government workers over to performance by private companies under procedures

Copyright © 1986 by The Bureau of National Affairs, Inc.
0014-9063/86/$00.50

Statement of
The Associated General Contractors of America
To The
Subcommittee on Administrative Law and Governmental Relations
Of The
Committee on the Judiciary
United States House of Representatives
On The Subject Of
The Proposed Program Fraud Civil Penalties Act, H.R.3335
February 6, 1986

AGC is:

- More than 30,000 firms including 8,400 of America's leading general contracting firms responsible for the employment of 3,500,000-plus employees;
- 110 chapters nationwide;

AGC members complete:

- More than 80% of America's contract construction of commercial buildings, highways, industrial and municipal-utility facilities;
- Approximately 50% of the contract construction by American firms in more than 100 countries abroad.

The Associated General Contractors of America appreciates the opportunity to submit its views on the proposed "Program Fraud Civil Penalties Act of 1985," H.R.3335.

The proposed Program Fraud Civil Penalties Act would establish, for the first time, a government-wide administrative mechanism to resolve small civil fraud cases outside the courts. These claims initially would be decided by hearing examiners. The Inspectors General of the various departments and agencies would initiate such claims when the Department of Justice makes a determination that the federal government has a valid claim but that it has neither the time nor the available resources to litigate. Any finding of liability in the administrative proceeding could be appealed to a federal circuit court.

AGC has great concern, however, that the mechanisms which would be established in H.R.3335 to discover cases of fraud overreach the government's authority over its citizens.

The bill's provisions relating to standards of proof and the implied limitation on judicial review appear to violate due process requirements.

In general, due process guarantees apply to the conduct of administrative agencies and officials. A person is entitled to procedural due process at any adjudicatory proceeding before an administrative agency. If liberty or property rights of an individual are involved in an adjudicatory proceeding, the following is required:

1. Notice and hearing, unless there is provision for appeal to a judicial tribunal.

2. Procedures consistent with the elements of a fair trial. These include:

   a. the right to conduct discovery;

   b. the right to cross-examine witnesses;

c. the right to offer evidence;

d. the right to meet claims of the opposing party and to present a defense; and

e. the right to counsel.

3. The determination by the administrative agency must be on sufficient evidence. Hearsay alone is not enough. In addition, the tribunal or hearing officer must make findings of fact and law and give reasons for the decision made.

4. The administrative proceedings must be impartial and unbiased. It is not necessary, however, for investigative and adjudicative functions to be undertaken by separate agencies or officials.

AGC has great concern that the above points are not recognized in H.R.3335.

In particular, AGC questions the need to apply the provisions of H.R.3335 to construction procurement. Procurement of construction is different from procurement of military hardware and office supplies. While payment for these latter goods is based on cost, payment for construction is based on a firm fixed price which was arrived at through intense competition. Virtually all of the public work purchased in the United States is procured using the competitively bid firm fixed price method of construction.

Contract modifications which are based on the contractor's costs are audited by the awarding agency. Contract modifications which exceed $100,000 are required by law to be audited; contract modifications in an amount less than that are audited at the discretion of the contracting officer.

Contract claims, like contract modifications, are required to be audited if they exceed $100,000 and are audited below that amount at the discretion of the contracting officer. Penalties for submitting false and fraudulent claims are already established by the False Claims Act.

There is no need for application of the provisions of H.R.3335 to the construction industry in light of the method of procurement used in the industry and the safeguards and controls which are already in place.

Therefore, AGC urges that if the subcommittee decides to advance the proposed "Program Fraud Civil Penalties Act of 1985," that it be amended to exclude the construction industry from its provisions.

American Farm Bureau Federation

WASHINGTON OFFICE
600 MARYLAND AVE. S.W.
SUITE 800
WASHINGTON, D.C. 20024
AREA CODE 202 - 484-2222

February 6, 1986

The Honorable Dan Glickman
Chariman
Administrative Law and
  Governmental Relations Subcommittee
House Judiciary Committee
Room B-351-A Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Glickman:

We are submitting the attached statement regarding program fraud civil penalties legislation on behalf of the American Farm Bureau Federation.

We ask that our statement be made a part of the hearing record.

Respectfully,

John Datt
John C. Datt
Executive Director
Washington Office

JCD/lh
Attachment
cc: Subcommittee Members

STATEMENT OF THE AMERICAN FARM BUREAU FEDERATION TO THE SUBCOMMITTEE ON ADMINISTRATIVE LAW AND GOVERNMENT RELATIONS OF THE HOUSE JUDICIARY COMMITTEE REGARDING PROGRAM FRAUD CIVIL PENALTIES LEGISLATION

February 6, 1986

The American Farm Bureau is the largest general farm organization in the country, with a current voluntary membership of nearly 3.4 million families in 49 states and Puerto Rico. At least 75 percent of the nation's farmers and ranchers are members of Farm Bureau in nearly 2,800 counties.

A great many farmers and ranchers are participants in a wide range of federal programs, particularly those administered by the Department of Agriculture, that require applications for services and benefits, thus involving contractural arrangements with the federal government. "Crop subsidy programs" have been mentioned by one of the chief sponsors of this legislation as one example of the serious areas of fraud that needs to be addressed.

We are in agreement with the purpose and thrust of the various bills concerning program fraud civil penalties that have been introduced in the House and Senate. However, we have some concerns regarding specific language in the bills that we ask the Subcommittee to seriously consider during this hearing and during markup of the legislation.

Rather than address the specific provisions of the various bills under consideration, we will state our concerns and recommendations in a general way.

First, we are concerned about the "knowledge" standard that is to be included in this legislation. Unless such a standard is clearly stated in the legislation, farmers and others doing business with the government will be subject to administrative citations of fraud that may be committed through inadvertent errors in filling out forms. Even the term "knows or has reason to know" is vague and subject to wide interpretation. At the very least, the Committee report should lay out the intent of the Congress in the use of that terminology. It should be made clear that agencies are not expected to proceed to bring actions based on inadvertent errors, oversights or misunderstandings. The preponderance of the evidence should show that the claimant committed fraud with full knowledge and intent.

Second, we are concerned about safeguards in the administrative proceedings. Language in some or all of the bills concerning subpoena authority indicates that broad authority is granted to the investigating official of the administrative agency, with no independent prosecutional review and unlimited subpoena power.

Congress must be exceedingly careful that basic constitutional rights are not weakened through this effort to alleviate fraud in dealings with the government. We suggest this language be carefully reviewed with the thought of reducing somewhat the power of the investigating official. It appears to us that the powers already available to administrative law judges in the Administrative Procedures Act are sufficient in this regard.

Third, we believe the monetary threshold of $100,000 contained in some of the bills is too high. Without doubt, the Justice Department would have an incentive to ignore cases under that threshold, even though it would have 90 days to take action before the administrative remedy proceeds. We believe this would have the effect of shifting far too many cases away from the regular judicial processes.

We realize that every decision reached by an administrative agency would be subject to appeal to the court of appeals, but that would be a most expensive undertaking for most farmers and the case would be tried on the record created by the administrative procedure. We believe the objective of the bills could be achieved without causing a major shift away from the responsibility of the Attorney General.

While we go along with reasonable legislation that would reduce the extent of fraud in dealings with the government, we want to point out that an administrative judgment of fraud can have a devastating effect on a farmer or other small businessman. If such a judgment is reached through due process, utilizing the normal safeguards our judicial system normally affords to any citizen, no farmer or other businessman can complain. However, if such a judgment is reached lightly, without ensuring independent prosecutorial review or without providing adequate judicial review, there can be no justification under our system of law.

We ask that this statement be made a part of the record.